

UNION FINANCIAL REPORTING AND DISCLOSURE

HEARING BEFORE A SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS UNITED STATES SENATE ONE HUNDRED EIGHTH CONGRESS FIRST SESSION

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THURSDAY, JULY 31, 2003

U.S. SENATE,
SUBCOMMITTEE ON LABOR, HEALTH AND HUMAN
SERVICES, AND EDUCATION, AND RELATED AGENCIES,
COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 3:47 p.m., in room SD-192, Dirksen Senate Office Building, Hon. Arlen Specter (chairman) presiding.
Present: Senators Specter, Craig, Harkin, and Murray.

OPENING STATEMENT OF SENATOR ARLEN SPECTER

Senator SPECTER. We now turn to the issue of proposed revision of forms for union financial reporting to the Labor Department, and our first witness is Ms. Victoria Lipnic. She has served as Secretary of Labor for Employment Standards since March 2002, has a bachelor's degree in political science and history from Allegheny College, and a law degree from George Mason University School of Law. Thank you very much for joining us, Ms. Lipnic.

Mr. Jonathan Hiatt and Ms. Jay Cochran, and Lynn Turner may all come to the panel table as well, if you would, please.

We have the 5-minute rule, as I think you have heard, and we look forward to your testimony.

STATEMENT OF HON. VICTORIA A. LIPNIC, ASSISTANT SECRETARY FOR EMPLOYMENT STANDARDS, DEPARTMENT OF LABOR

Ms. LIPNIC. Thank you, Mr. Chairman. Mr. Chairman, Senator Harkin, members of the committee, I am pleased to appear before you today to discuss the Department of Labor's proposed revision of forms used by labor organizations to file the annual financial reports required under the Labor-Management Reporting and Disclosure Act of 1959, also known as the Landrum-Griffin Act.

Mr. Chairman, I would ask that my longer written statement be submitted for the record, and I will briefly summarize my testimony in the time permitted.

The Landrum-Griffin Act is one of a number of important statutes administered by the Department of Labor to safeguard the rights of workers. The LMRDA is administered by the Office of Labor-Management Standards at the department. The LMRDA was enacted in 1959 after congressional investigations into the labor and management fields found corruption, disregard for employee rights, breaches of trust, and other unethical behavior.

The LMRDA is centered on three fundamental goals: promoting union democracy, providing fiscal transparency, and ensuring union financial integrity. We take very seriously our responsibility to enforce each of the important worker protection statutes administered by the Department and are not at liberty to treat any one of the statutes we enforce as less important than the other.

A critical part of our enforcement strategy and indeed a central part of the LMRDA enforcement, as set out by Congress, is for union members to be able to engage in effective self-governance. In order to do so, it is appropriate that there be some periodic review of the rules and regulations under the statute in order to ensure that they continue to fulfill the statutory goals and are relevant to the work force today.

In setting out on this rulemaking, the Department asked three critical questions. First, are there any changes to the current reporting forms necessary in order to provide increased transparency and accountability for union members? Second, are there ways to take advantage of the technology that heretofore did not exist to facilitate providing some more meaningful information to union members? And third, will the changes regarding increased transparency and accountability benefit union members?

We believe the answer to all three of these questions is yes. People who believe in strong unions, strongly committed to advancing members' welfare should want a strong Landrum-Griffin Act that brings union finances into the sunshine and ensures that union leaders are working for their members, not against them, by preying on union funds and members' dues.

Title II of the LMRDA requires reports from unions, union officers, employees, employers, labor relations consultants, and surety companies.

The Act grants broad authority to the Secretary to issue regulations prescribing the form of the reports required by the statute and other reasonable rules and regulations necessary to prevent the circumvention or evasion of the reporting requirements.

Senators, Secretary Chao firmly believes that no entity should be allowed to shield its finances from its members. Unfortunately, OLMS' existing financial reporting forms, which were created nearly 40 years ago, have been substantially unchanged since then, and they have simply not kept pace with changes in financial practices. The existing forms utilize such broad, general categories that union management could easily use to hide overspending, financial mismanagement, and other irregularities from their members. It is impossible, for example, for union members to evaluate in any meaningful way the management of their unions when the financial disclosure reports filed with the Department include items like \$7,800,000 for civic organizations, or \$62 million to grants for joint projects with State and local affiliates. Such aggregate entries make it virtually impossible for members to determine how their dues money was spent.

In December 2002, the Department published a notice of proposed rulemaking to revise the form LM-2, the annual reporting form used by the largest unions, and to revise, although less significantly, Forms LM-3 and LM-4 which are used by smaller unions. The Department proposed these changes in order to ensure

the continuing relevance of the reporting requirements of the LMRDA and to promote the overarching purposes of union reporting to fully inform union members about their union's financial condition and operations and to deter the abuse of stewardship duties by those union officials and employees who might otherwise be inclined to take advantage of their positions.

The Act expressly requires that reports filed with the Secretary be made public. The public nature of the contents of these reports allows members and the public, in addition to the Department, an opportunity to review a union's financial information as a check on the actions of its officials. These purposes can only be served if the information that is reported is meaningful, and it follows that, as illustrated by the examples I gave earlier about the extraordinarily broad information being captured by the current LM-2 form, a certain level of detail is necessary to make it meaningful.

Only unions with receipts of \$200,000 or more per year and unions that are in trusteeship are required to use the form LM-2. Accordingly, approximately 20 percent of all reporting unions, or approximately 5,500 unions out of approximately 30,000, use form LM-2 reports. The new forms will provide union members, the Department, and other interested parties with more information about the financial conditions and operations of unions. The changes proposed include requiring LM-2 filers to file electronically using software that the Department will provide to the unions.

The Department also proposed a new form, the T-1, on which a labor organization would report information about a trust or its interest in a trust.

I would also add the Department proposed to make these changes effective for each union's fiscal year that begins after the final rule is published. Since unions do not have to file their annual reports until 90 days after the end of their fiscal year, this means that the earliest possible date a union would need to file a report under the new rule would be 15 months after any final rule is published, and the Department specifically sought comment on the effective date.

Mr. Chairman, the Department appreciates that this proposal has engendered serious comment and debate. In fact, we embarked on this rulemaking precisely to engage all sides in that debate. The comment period for this rule closed on March 27. During this time, the Department received more than 35,000 comments. Although many of these comments expressed opposition to the Department's proposal to revise the forms, many other comments expressed support for the proposal. Many lengthy, substantive, and specific comments were received from local intermediate national and international labor organizations, employers and trade organizations, public interest groups, accountants, accounting firms, academicians, and Members of Congress. The Department is carefully reviewing all of the comments and will give all points of view careful consideration.

PREPARED STATEMENT

I would be pleased to take your questions, but certainly note for the record that because we are in the midst of the rulemaking, we

will consider all of the comments in the record before we decide any further steps.

[The statement follows:]

PREPARED STATEMENT OF VICTORIA A. LIPNIC

Mr. Chairman and Members of the Subcommittee: I am pleased to appear before the Subcommittee today to discuss the Department of Labor's proposed revision of forms used by labor organizations to file the annual financial reports required under the Labor-Management Reporting and Disclosure Act of 1959 (LMRDA), also known as the Landrum-Griffin Act.

The LMRDA was enacted in 1959 after congressional investigations into the labor and management fields found corruption, disregard for employee rights, breaches of trust, and other unethical behavior. The central message of the Landrum-Griffin Act is that financial transparency is critical to protecting workers. It establishes the basic "right to know" for union members.

The Landrum-Griffin Act is one of a number of important statutes that have been passed over the years to safeguard the rights of workers. We have the Occupational Safety and Health Act to protect worker safety, the Fair Labor Standards Act to guarantee worker wages, the Employee Retirement Income Security Act to protect worker pensions, and the Landrum-Griffin Act to protect the rights of union workers. We take very seriously our responsibility to enforce each of these statutes. Congress passed each of these statutes in order to protect the rights of American workers, and the Department is not permitted to treat one of these statutes as less important than any other statute.

People who believe in strong unions, strongly committed to advancing members' welfare, should want a strong Landrum-Griffin Act that brings union finances out into the sunshine and ensures that union leaders are working for their members, not against them by preying on union funds and member dues. As AFL-CIO President George Meany noted at the time, "if the powers conferred [in the Landrum-Griffin Act] are vigorously and properly used, the reporting requirements will make a major contribution towards the elimination of corruption and questionable practices."

The LMRDA is centered on three fundamental goals—promoting union democracy, providing fiscal transparency and ensuring union financial integrity.

The Employment Standards Administration's Office of Labor-Management Standards (OLMS) administers and enforces the provisions of the LMRDA that are within the jurisdiction of the Department of Labor. These include civil and criminal provisions that provide standards for achieving the goals of the statute. OLMS also administers and enforces provisions of the Civil Service Reform Act of 1978 and the Foreign Service Act of 1980, which apply similar standards to Federal sector unions.

Title II of the LMRDA (the Act) requires reports from unions, union officers and employees, employers, labor relations consultants, and surety companies. The Department of Labor has authority to enforce these reporting requirements, and the Act provides for the public disclosure of the reports. In addition, union members have the right to examine the underlying union financial records in order to verify the reports filed pursuant to the Act, but can enforce that right only by demonstrating just cause in Federal court. However, a member can obtain neither the records, nor attorney fees, if the court does not agree that just cause has been demonstrated.

The LMRDA requires each labor organization to include in its annual financial report the following information:

- (1) assets and liabilities at the beginning and end of the fiscal year;
- (2) receipts and their sources;
- (3) payments to officers and employees;
- (4) loans over \$250 to officers, employees, or members, along with an explanation for each loan;
- (5) loans to businesses, along with an explanation for each loan; and
- (6) other payments made, along with explanations, in categories the Secretary of Labor designates.—29 U.S.C. § 431(b).

In addition to the annual union financial report, the Act requires officers and employees of covered labor organizations, as well as employers and labor consultants to report other information periodically. The Act grants broad authority to the Secretary to issue regulations prescribing the form of the reports required by the statute and other reasonable rules and regulations "necessary to prevent the circumvention or evasion of [the] reporting requirements."

THE DEPARTMENT'S PROPOSAL TO REVISE FORM LM-2 AND CREATE A FORM T-1

Secretary Chao firmly believes that no entity should be allowed to shield its finances from its shareholders. Unfortunately, OLMS' existing financial reporting forms, which were created 40 years ago and have been substantially unchanged since then, simply have not kept pace with changes in financial practices. The existing forms utilize such broad, general categories that union leaders could easily use them to hide overspending, financial mismanagement, and other irregularities from their members. It is impossible, for example, for union members to evaluate in any meaningful way the management of their unions when the financial disclosure reports filed with DOL include items like \$7,805,827 for "Civic Organizations," \$62,028,329 for "Grants to Joint Projects with State and Local Affiliates," or \$7,863,527 for "Political Education." Such aggregate entries make it virtually impossible for members to determine how their dues money was spent.

In December 2002, the Department published a Notice of Proposed Rulemaking to revise Form LM-2, the annual reporting form used by the largest unions, and to revise, although less significantly, Forms LM-3 and LM-4, which are used by smaller unions. The Department proposed these changes in order to ensure the continuing relevance of the reporting requirements of the LMRDA and to promote the overarching purposes of union reporting: to fully inform union members about their union's "financial condition and operations," and to deter the abuse of stewardship duties by those union officials and employees who might otherwise be inclined to take advantage of their positions. The form that is currently used by the largest labor unions to file their annual reports has not been significantly changed in 40 years and provides only general information that is of limited use to union members. The Department's proposal is an attempt to ensure that union members are provided with information that is relevant today and will enable them to play a meaningful role in the governance of their unions.

The Act expressly requires that reports filed with the Secretary be made public. The public nature of the contents of these reports allows members and the public, in addition to the Department, an opportunity to review a union's financial information as a check on the actions of its officials and employees. These purposes can only be served if the information that is reported is meaningful and a certain level of detail is necessary to make it meaningful.

Only unions with receipts of \$200,000 or more per year and unions that are in trusteeship are required to use the Form LM-2. Accordingly, approximately 20 percent of all reporting unions (or approximately 5,500 unions out of approximately 30,000 unions) use Form LM-2 reports. The new forms will provide union members, the Department, and other interested parties with more information about the financial activities of unions. The changes proposed include requiring Form LM-2 filers to file electronically using software the Department will provide to labor organizations. The proposed revision also requires information about accounts payable and receivable that are more than 90 days overdue at the end of the reporting period, changes the minimum amounts for reporting the value of certain investments from \$1,000 and 20 percent of the total value to \$5,000 and 5 percent respectively, requires unions to estimate the percentage of time that its officers and employees spend on various duties and to allocate that time in relationship to the union's payments for those duties, requires information about different categories of union membership and the number of members in each category instead of simply reporting the total number of members, and requires labor organizations to provide specific information about certain major receipts and major disbursements in several categories.

The proposed revised Form LM-2 would require itemization of the following receipts and disbursements categories:

- Other Receipts (Schedule 14)
- Contract Negotiation and Administration (Schedule 15)
- Organizing (Schedule 16)
- Political Activities (Schedule 17)
- Lobbying (Schedule 18)
- Contributions, Gifts, and Grants (Schedule 19)
- Benefits (Schedule 20)
- General Overhead (Schedule 21)
- Other Disbursements (Schedule 22)

However, the proposed Form LM-2 does not require itemization or a supporting schedule of any type for the following receipts and disbursements categories:

- Dues and Other Payments (Receipts)
- Per Capita Tax (Receipts)
- Fees, Fines, Assessments, Work Permits (Receipts)

- Sale of Supplies (Receipts)
- Interest (Receipts)
- Dividends (Receipts)
- Rents (Receipts)
- On Behalf of Affiliates for Transmittal to Them (Receipts)
- From Members for Disbursement on Their Behalf (Receipts)
- Per Capita Tax (Disbursements)
- Strike Benefits (Disbursements)
- Fees, Fines, Assessments, etc. (Disbursements)
- Supplies for Resale (Disbursements)
- To Affiliates of Funds Collected on Their Behalf (Disbursements)
- On Behalf of Individual Members (Disbursements)

Many of the categories in the proposed revised form are the same ones that are in the existing form. The Department proposed to drop seven categories from the current form (on Statement B the following categories were eliminated—To Officers; To Employees; Office and Administrative Expense; Educational and Publicity Expense; Professional Fees; Direct Taxes and Withholding Taxes) and to add six categories that are not on the current form (Contract Negotiation and Administration; Organizing; Political Activities; Lobbying; General Overhead; and Strike Benefits).

The Department also proposed a new form, the T-1, on which a labor organization would report information about its interest in a trust or other fund established or governed by the labor organization primarily for the benefit of its members. The LMRDA specifically authorizes the Secretary to issue rules requiring “reports concerning trusts in which a labor organization is interested,” which the statute defines as:

“ . . . a trust or other fund or organization (1) which was created or established by a labor organization, or one or more of the trustees or one or more members of the governing body of which is selected or appointed by a labor organization, and (2) a primary purpose of which is to provide benefits for the members of such labor organization or their beneficiaries.”—29 U.S.C. § 402(l).

In the past, the current LM-2 form has required unions to simply disclose whether they have created or participated in the administration of a trust. If so, the unions are required to disclose the name, address, and purpose of each trust and to disclose the file number for reports filed under the Employee Retirement Income Security Act, if applicable. The current form has also required a union to report in full about the financial transactions of wholly owned, controlled and financed subsidiaries. Subsidiaries that meet this test are, in effect, no different from the union itself. Many unions, however, engage in extensive financial dealings with trusts that meet the statutory definition of a trust in which a union is interested but do not meet the Form LM-2 subsidiary definition. For example, a trust may have several participating unions, or be jointly controlled by a union and an employer, or may have several “owners” as in the case of a member-owned credit union. The current Form LM-2 does not require a union to report any information about such a trust—other than its existence, name, address, purpose, and the file number for reports filed under the Employee Retirement Income Security Act, if there is one—even though a very significant amount of union dues may be spent through such a fund. Because these transactions are unreported, the purpose of the reporting requirements of the LMRDA can be easily circumvented. In a sense, expenditures made by a trust on the union’s behalf are simply off the books, even though the original source of the funding may be members’ dues or funds contributed by employers pursuant to union negotiated agreements. The Department proposed to eliminate this means of evading the reporting requirements of the statute and to require unions to provide significantly more information about such trusts than previously available.

The Department proposed to make these changes effective for each union’s fiscal year that begins after the final rule is published. Since unions do not have to file their annual reports until 90 days after the end of their fiscal year, this means that the earliest possible date a union would need to file a report under the new rule would be fifteen months after the final rule is published. The Department specifically asked for comments on the effective date.

The Department also specifically requested comments on many aspects of its proposal. Recognizing that it did not have as much information about the way unions keep accounts as unions themselves and recognizing that it was important to hear from union members, as well as unions, regarding the assumptions underlying the proposal, the Department requested comments on such issues as the appropriate threshold for filing a Form LM-2, the appropriate level for itemizing certain receipts and disbursements, whether the statutory definition of a trust should be used to re-

quire reports regarding financial transactions of such entities, and whether these requirements are unduly burdensome. The Department also recognized that certain financial information, while important to union members, might result in harm to union interests if disclosed publicly. Accordingly, the Department proposed that information regarding disbursements for organizing not include the name of the employer or bargaining unit involved. The Department also sought specific comments as to whether this measure was sufficient to protect legitimate union interests while providing an important measure of transparency.

COMMENTS RECEIVED

The comment period for this rule, including a 30-day extension, was open from December 27, 2002, to March 27, 2003. During this time, the Department received over 35,000 comments. Although many of these comments expressed opposition to the Department's proposal to revise the forms, many other comments expressed support for the proposal. Many lengthy, substantive, and specific comments were received from local, intermediate, national and international labor organizations, employers and trade organizations, public interest groups, accountants, accounting firms, academicians and Members of Congress.

The Department is carefully reviewing all of the comments and will give all points of view careful consideration. Many union members expressed support for the proposed rule and suggested that it was "long overdue." Some union members and other commenters advocated even more sweeping change. Some comments from union members centered on their personal difficulties in obtaining financial information from their unions, describing fruitless attempts to obtain information about union finances from the union leadership. Other union members supported the initiative as a means of deterring fraud by union leaders; one said, "It will be a great victory for [the union's] membership when the reform is passed."

Many commenters opposed the proposed changes, believing that the changes will hamper the ability of unions to service their members and strain union budgets. Many commented that the proposed rule was burdensome and argued that the detail that would be required of unions was greater than that required of corporations. Other commenters argued that the requirements proposed do not comport with Generally Accepted Accounting Principles (GAAP) and are beyond the Secretary's authority. Union commenters have argued that requiring unions to report identifying information about those who receive disbursements for organizing activities could reveal union organizing strategies and place individuals at risk or that other itemized disclosures could result in an invasion of privacy for individuals reimbursed for medical fees or burial expenses.

Some commenters have expressed concern that the changes were intended to expand *Beck* requirements to appease anti-union organizations and to provide more information to employers and anti-union organizations. Many comments were received on the proposal to revise the information to be reported by unions about disbursements to officers and employees and to require unions to report, by estimation to the nearest 10 percent, how these individuals spent their working time. Unions objected to this proposal as disruptive, intrusive, burdensome, and expensive. The Department is currently reviewing all of the comments and takes all of these concerns very seriously.

Some commenters have compared the Department's current proposal to an earlier attempt by the Department to revise the LM-2 form to require "functional reporting" by unions. The Department's current rulemaking is very different from the rule published by the Department in 1992, revising the form. The Department rescinded most of this rule at the end of 1993, but retained the Form LM-4 for the smallest unions, as well as the increased threshold for filing Forms LM-2 and 3. These two elements of the 1992 rule remain today. The 1993 rule rescinding the 1992 revisions also left in place, and the current Form LM-2 includes, the requirement that labor organizations report all disbursements during the reporting period in certain defined categories. It rescinded, however, the requirement for a second allocation of the same disbursements into additional categories reflecting only functional activities.

TECHNOLOGICAL DEVELOPMENTS

Significant improvements in accounting software since 1993 make it possible to change the Form LM-2 in ways that will provide additional useful information to union members and the public without unduly burdening unions. Most importantly, the current proposal takes advantage of technology developed over the last 10 years that simplifies maintaining, reporting and accessing the required financial information. Computers and financial management programs have become much more wide-

ly used. Internet access is more commonly available and the benefit of making information available over the Internet has been generally, and Congressionally, recognized. These changes make it possible to provide substantially more information to union members and the public with less burden on unions than the changes considered in 1992 would have imposed at that time.

The Department is providing technical specifications and electronic software to greatly ease the process of functional reporting and facilitate the use of the new LM-2 generally. The Department will also provide extensive compliance assistance to unions and is planning briefings, workshops, a help desk and toll-free telephone assistance. Helpful information will be made available to unions through mass mailings, a list-serve email system, and on the Department's website.

Beginning in 1997, at the request of Congress, the Department has pursued a course towards the development and implementation of electronic filing of annual reports required by the LMRDA, along with an indexed and easily searchable computer database of the information submitted, accessible by the public over the Internet. In January 2002, the Department began distributing to labor organizations a free CD-ROM containing a computer software program that they can use to electronically complete the annual financial reports they currently are required to file. Those reports can now be submitted over the Internet. Further, these annual reports, as well as the reports of employers and labor relations consultants, now are available for public disclosure on the Internet. All of these reports for the year 2000 and later can now be examined from any computer with access to the Internet and printed free of charge. The proposed rule's requirement that all Form LM-2s be filed electronically, with an exception for situations where it would impose real hardship, will greatly facilitate the Department's efforts to maintain such access, as Congress has repeatedly directed us to do. The Department is pleased to have the technological capability to assist unions with their reporting requirements, as we attempt to improve labor accountability and protect union members and the public.

Mr. Chairman, the Department appreciates that this proposal has engendered serious comment and debate. In fact, the Department embarked on this rulemaking precisely to engage all sides in that debate. I would be pleased to take your questions, but must note for the record that the Department is in the midst of the rule-making and must carefully consider the entire record before deciding on any next steps.

Thank you for giving me the opportunity to discuss these important reporting changes. I would be pleased to answer your questions.

STATEMENT OF JONATHAN P. HIATT, GENERAL COUNSEL, AFL-CIO

Senator SPECTER. Thank you very much, Ms. Lipnic. We now turn to Mr. Jonathan Hiatt, General Counsel of AFL-CIO since November 1995, a graduate of Boulton Hall School of Law, UCal and Harvard College. Thank you for joining us, Mr. Hiatt, and the floor is yours.

Mr. HIATT. Thank you very much, Senator Specter, Senator Harkin, and members of the subcommittee.

We filed written testimony describing our major concerns. So for now, I would simply like to emphasize three key points that go to the heart of our opposition and illustrate the proposal's fundamental flaws.

I would stress at the outset that we do not take issue in any way with the underlying principles of the LMRDA that Ms. Lipnic alludes to or are supportive of union democracy or the general principles underlying the importance of sunshine and transparency.

The first of our key concerns, however, with this proposal involve the enormous financial burdens that this proposal would impose upon unions. The second involves a comparison of these requirements that the Labor Department seeks to impose on unions, in contrast to the financial reporting obligations that pertain to virtually all other profit and nonprofit organizations. And the third involves the Department's stated goals of transparency in deterring fraud and embezzlement and the plain fact that this proposal would be entirely ineffective in achieving these goals.

A Department that has publicly deplored imposing regulatory burdens of any kind on employers has here proposed sweeping new requirements in union reporting and record keeping that have not been deemed necessary for some 45 years. There are some 16 major proposed changes, but probably the single most onerous would be the requirement that unions itemize every disbursement to a single entity that in their aggregate reach a threshold proposed to be in the range of \$2,000 to \$5,000 and then to allocate the costs to one of eight very rigid functional categories without any regard to the specific programs that any one particular union is engaged in.

Just to give you an example, if a union receives bills during the course of a year from a certain printer, each bill may be totaling \$200, \$250, the fact that those bills by the end of the year may total \$2,000 to \$5,000 means that the union would have to keep track of every bill, would have to record information concerning the vendor, the date, the address, the cost, the purpose of that particular job, the description of it, and that would all have to be allocated by category. Some of that bill may have gone to work done for an organizing campaign, some in connection with a training conference, some in connection with negotiations. It would all have to be broken down, that one bill, into many, many transactions because of the possibility that by the end of the year that printer would have been paid a total of \$2,000 to \$5,000 or more.

In addition to the substantive changes that will be required, unions will have to file their LM reports electronically with software that the Department has promised to provide, as Ms. Lipnic says, but which does not yet even exist.

The revisions would apply to all covered unions with annual receipts of at least \$200,000. That is a total of 5,426 unions, of which only 141 are national unions. So the rest, some 97 percent, are local unions. For the most part, these are small volunteer organizations whose officers hold full-time jobs and also run the local. Their resources are limited as is their wherewithal to fill out complex and time-consuming forms. They do not have a bevy of paid staff. Some have none. They do not have sophisticated computer equipment or consultants to help them to do their jobs. Yet, the Department proposes to saddle them with unsurpassed record keeping and reporting obligations.

DOL estimated that the average burden per union for the revised form after the first year would be just a few hundred dollars per union, or a total cost for all unions of somewhere between \$2 million and \$3 million per year. These figures so thoroughly underestimate the burden on the regulated entities as to defy logic and common sense. And they know it. And I say they know it because the Department admits that they had no data on which to base these numbers, so that the numbers amount to nothing more than guesswork. They conceded in the Federal Register that it would be incumbent upon the unions, responding in their comments, to provide the information concerning the actual burden costs.

The one empirical study that has now been performed based on a survey of national local unions shows that the average cost to national unions would be over \$1 million a year and to local unions over \$217,000. In other words, the total cost for all unions, varying based on what methodology is used and whether you use average

or median costs of the samples involved, range from \$300 million to \$1.1 billion. Compare that to the Department's \$2 million to \$3 million range. It is as if DOL would simply ignore the fact that to comply with its proposal, unions will have to classify, identify, and describe virtually every expenditure by functional category, assign staff and officer time by functional category, train and allocate additional time for staff and officers to keep records that meet the new requirements, adapt existing hardware and software to fulfill the new requirements, and pay for sufficient computer and accounting expertise.

I will let the next witness speak to the second point about relative inequity because I understand that former SEC Chief Accountant Lynn Turner will be describing the differences that are imposed on corporations compared to that that this proposal would impose on unions. But the key point there is at least the SEC understands that disclosure of information and financial reporting is based on what is material information, what is looked at as material information under the generally accepted accounting principles which govern both for-profit and not-for-profit entities.

Here the Department would be requiring every single transaction regardless of how minute, how detailed, and how unimportant that particular transaction is to the overall financial stability of the organization.

Finally, the Department's own deterrence claim is completely unsupported. There is simply nothing in the accounting literature to support the notion that itemization deters corruption. Instead, the literature makes plain that verification of the reliability of financial statements is provided through the well-established system of outside auditing by highly trained professionals who know how to verify that allocations are properly made and that organizations have adequate internal controls to ensure that corruption cannot take root.

PREPARED STATEMENT

That takes me to my conclusion. The AFL-CIO and our affiliates, while we support disclosure that provides meaningful and useful financial information to union members in aid of union democracy and fiscal accountability, we have indicated our willingness to work with the Department to explore a requirement that LM-2 filers would undergo an independent audit each year by a certified public accountant, tailored to their size and resources, that would potentially provide much more meaningful information to union members and provide a much truer test of the integrity of their union's financial accounting systems. But in the meantime, we would certainly hope you would urge the Department to withdraw this proposal.

Thank you.

[The statement follows:]

PREPARED STATEMENT OF JONATHAN P. HIATT

INTRODUCTION

Thank you, Mr. Chairman, for the opportunity to testify today before this subcommittee on the Department of Labor's proposal to revise union financial reporting

requirements under the Labor Management Reporting and Disclosure Act. This is an issue of tremendous significance for the labor movement.

As you know, the AFL-CIO and its affiliated unions oppose the Department's proposal. Today I want to emphasize three points that underlie our opposition and illustrate the proposal's fundamental flaws. First, the proposal will impose enormous—and in many cases insuperable—financial burdens on unions. Second, the proposal violates basic principles of fairness, as no other organizations, whether profit-making or non-profit, bear such onerous financial reporting obligations as the Department seeks to impose on unions. Third—although not least important—the Department's proposal will be entirely ineffective in achieving its purported goals of transparency and deterring fraud and embezzlement. For all of these reasons, the proposal lacks any justification.

Before I address each of these issues, I want to reiterate that the AFL-CIO and its affiliates deplore the misuse of union members' dues wherever and whenever it occurs. There is no contradiction, however, between our staunch opposition to fraud and embezzlement and our equally staunch opposition to the Department of Labor's proposal. On the contrary, precisely because of our commitment to union financial integrity we oppose rules that would divert union members' dues from their intended purpose of providing strong and effective workplace representation and redirect them into costly, time-consuming, and irrational reporting.

STATUTORY AND REGULATORY BACKGROUND

Congress passed the LMRDA in 1959. Expressing support for the Act, George Meany stated in his testimony before the House Labor Committee, "if the powers conferred [in the LMRDA] are vigorously and properly used, the reporting requirements will make a major contribution towards the elimination of corruption and questionable practices." These powers conferred on the Department of Labor by the LMRDA include not only reporting requirements for labor organizations, but also reporting requirements for employers and their consultants. This is because Congress, as early as 1959, was also concerned with the growing practice of so-called management consultants who were hired by employers to threaten and intimidate workers who attempted to exercise their rights under the National Labor Relations Act to choose a union. Thus, Section 203(b) of the LMRDA requires management consultants to file a report with the Department of Labor if they have been hired by an employer "to persuade employees to exercise or not to exercise, or persuade employees as to the manner or exercising, the right to organize and bargain collectively through representatives of their own choosing." (29 U.S.C. § 433(b)). And, that same section of the LMRDA requires employers also to file a report with the Department documenting that they have hired such a consultant. (29 U.S.C. § 433(c)).

I know that we are not here to discuss these "persuader reports" and their employer counterparts. However, this Subcommittee cannot fully evaluate the impact of the changes proposed by the Department to union financial reports without taking notice of the fact that virtually no employer and consultant reporting takes place under the Act at present. This is so because the Administration has interpreted the relevant statutory provisions to mean that unless a management consultant has face-to-face contact with workers, that consultant has no obligation whatsoever to file a persuader report, even though the consultant plans, scripts, and directs a virulent union-busting campaign on behalf of the employer. In fact, in one of the first official acts of the Bush Administration, the Labor Department rescinded an interpretation of this requirement by the Clinton Administration that would have required management consultants to file reports regardless of whether they operated behind the scenes or in person to persuade employees not to vote for a union.

Thus, while Congress made it clear that "[g]reat care should be taken not to . . . weaken unions in their role as collective bargaining agents" through enforcement of the Act (S. Rep. No. 187, 86th Cong., 1st Sess. 1959), this is precisely the situation we face today. At the same time as the Department has abandoned its enforcement responsibilities with respect to employers and unionbusting consultants, it intends to saddle unions with unprecedented and unjustified burdens.

I also want to emphasize how much unions already have to disclose under the LMRDA. Under Section 201(b), each covered labor organization must file annual financial reports with the Department of Labor setting forth information in six categories "in such detail as may be necessary accurately to disclose its financial condition and operations for its preceding year . . ." (29 U.S.C. § 431(b)). The LMRDA also requires unions to make those reports available to their members. In addition, the statute goes one step further, however, and requires unions to "permit . . . [their] member[s] for just cause to examine any books, records, and ac-

counts necessary to verify such report,” and union members can enforce this right in federal court.—29 U.S.C. § 431(c).

In practice, unions do not require their members to prove “just cause” in order to inspect the books and records. Rather, they make those materials freely available to members upon request. As democratic institutions, unions at the local level hold monthly membership meetings where, typically, the treasurer of the local provides a financial report and is available to answer questions about the union’s treasury. International unions almost universally conduct annual audits by independent certified public accountants. These audits are often published in the union’s newsletter or otherwise made available to the entire membership.

SUMMARY OF THE PROPOSAL

Despite the breadth of the current statutory and regulatory schemes, the Department has proposed sweeping changes in union reporting and recordkeeping requirements. These proposed revisions apply to all unions with annual receipts of at least \$200,000 that file form LM-2 under the LMRDA. These changes include:

Itemization.—Unions must itemize every disbursement to a single entity/person that reaches a threshold (proposed in the range of \$2,000 to \$5,000), and allocate the cost to one of 8 functional categories (schedules), including contract negotiation and administration; organizing; politics; lobbying; and general overhead.

Aging Accounts.—Unions must itemize accounts payable/receivable over \$1000 according to how many days they are past due.

Allocation of Officer/Employee Time & Salary.—Unions must estimate to nearest 10 percent all officer time and allocate it to the 8 functional categories, along with salary and withholdings; same for employees who receive at least \$10,000 per year.

Dues Itemization.—Unions must categorize membership, dues, and per capita tax by membership categories that include agency fee payers.

Trusts.—Unions (even if they do not file LM-2) must file a new T-1 report for “trusts”—entities in which they appoint at least one trustee/person on the governing body; that have a primary purpose to provide benefits to the union’s members; that have receipts of at least \$200,000 per year; and to which the union has contributed or has had a contribution made on its behalf of at least \$10,000. This substitutes for and is broader than current “subsidiary” reports. Trusts may include credit unions, joint funds under a collective bargaining agreement, building funds, education or training institutions, redevelopment or investment funds (unless trust files certain other reports).

Intermediate bodies.—Conferences, joint committees, joint or system boards, or joint councils not currently covered by the reporting requirements must file if subordinate to a labor organization that is covered under the LMRDA.

Electronic filing.—Unions must file their LM-2 reports electronically with software that the Department has promised to provide, but which does not yet exist. Many smaller LM-2 filers file manually and will have to invest in electronic systems to comply. Those unions that keep their records electronically will also face huge costs since they will have to adapt their systems to the new LM requirements. Compliance will generate ongoing costs as well.

THE DEPARTMENT’S PROPOSAL IMPOSES AN UNTOLD BURDEN ON UNIONS

No factor may be more critical in determining whether this proposal should become a final rule than the burden it would impose on the regulated unions. As you know, the proposal to revise what is known as the “LM-2” form affects all unions with annual receipts of at least \$200,000. According to the Department itself, 5,426 unions filed LM-2’s in 2000. Only 141 of these unions were national or international bodies. This means that almost 5,300 LM-2 filers—a figure that represents 97 percent of all such filers—are local unions. For the most part, these are small, volunteer organizations whose officers hold full-time jobs and also run the local. According to the Small Business Administration, they are all small businesses (67 Fed. Reg. at 79290), not, as the Department asserts, entities that “resemble modern corporations in their structure, scope and complexity.” (*Id.* at 79280). Their financial resources are limited, as is their wherewithal to fill out complex and time-consuming forms. They do not have a bevy of paid staff, sophisticated computer equipment, or consultants to help them do their jobs. Nonetheless, the Department proposes to saddle them with unsurpassed recordkeeping and reporting burdens.

According to the Department’s Paperwork Reduction Act analysis, the average reporting burden per union for the revised form LM-2 will be 104.03 hours in the first year, 24.96 hours in the second year, and 21.81 hours in the third year. 67 Fed. Reg. at 79297. For each of these years the Department estimates that unions will experience only one hour of recordkeeping burden. *Id.* at 79296, 79297. The Depart-

ment estimates total annual cost to LM-2 filers in the first three years as \$14.618 million, \$3.281 million, and \$2.867 million, respectively. *Id.* at 79293. These figures so thoroughly underestimate the burden on the regulated entities as to defy both logic and common sense.

Why are the Department's burden estimates so inherently unreliable? This is because the Department has no data on which to base these numbers, so the numbers amount to nothing more than guesswork. Let me briefly list just some of the material gaps in the Department's knowledge to show that DOL could not possibly have performed a meaningful burden analysis or arrived at a credible burden estimate:

- The Department concedes at the outset of its proposal that “[i]nformation regarding the burden imposed by making the proposed changes . . . is most likely to be obtained by proposing the changes for comment so that unions . . . can express their views.” (67 Fed. Reg. at 79282);
- The Department has not yet designed, developed, or tested the software it will require unions to use when submitting their revised financial reports that it claims will minimize the unions' burden of complying with the proposal. 67 Fed. Reg. at 79282);
- The Department admits that “no specific data exists regarding the extent to which unions have already embraced the technology necessary to provide reports in electronic form.” (67 Fed. Reg. at 79282);
- The Department assumes, without further inquiry, that unions maintain their records in precisely the way that the proposal seeks to capture the information. (67 Fed. Reg. at 79288);
- When the AFL-CIO asked for all records underlying the specific time and dollar estimates set forth in the proposal, the Department asserted that “no identifiable records” exist.

We responded to the Department's invitation to come up with our own burden estimate by hiring an economist and performing our own survey, a copy of which I have attached to my testimony. This is the only empirical study of the burden to unions that would be imposed by the Department's proposal. The survey identified 16 significant actions that unions would need to take in order to comply with the proposal, such as maintaining new records and charts of account, adapting existing hardware and software, and obtaining sufficient accounting, computer, and legal expertise on an ongoing basis. Each responding union was asked first to rank the difficulty of complying with a given change and then to estimate the cost of compliance with that change. In nearly every instance, a union's chief financial officer, comptroller, or secretary-treasurer completed the survey. Most of these individuals have many years of experience filing the LM-2, and they drew upon this experience in estimating the likely cost of the Department's proposed changes.

In our comments to the Department of Labor we have asserted that the total cost of complying with the revised financial reporting requirements is anywhere from \$309 million to \$1.1 billion. As the following discussion reveals, these numbers are derived from our study, and vary according to the way in which the data is aggregated.

Our survey reveals that the average cost to national/international unions of complying with the 16 changes is \$1,239,482. The average cost to local unions of complying with the 16 changes is \$217,509. Median estimates are \$422,700 for national/international unions and \$138,000 for locals.

These data on average and median cost per national/international and local union were then utilized to develop an overall burden estimate for unions affiliated with the AFL-CIO. Using the average per union figures above, the total burden estimate for national/international unions is \$80,566,330. For local unions, the total burden estimate is \$1,078,627,131. The combined total is \$1,159,193,461 (which represents the high end of our estimate). Using the Department of Labor's e.LORS database, Professor John Lund of the University of Wisconsin performed an analysis of LM-2 filers nationwide and developed a distribution of LM-2 filers by nine levels of revenue. Unions that responded to the 2003 AFL-CIO survey were then similarly distributed by level of revenue, and average and median burdens were calculated in each category. Using this methodology, the total average cost to unions across revenue tiers is \$552,249,334, while the total median cost to unions across revenue tiers is \$309,175,462 (which represents the low end of our estimate).

As you can see, these estimates are radically different from those that the Department came up with. But, as I have already stated, they are the only estimates based on legitimate, empirical data about the regulated community and they make a mockery of the Department's miniscule figures. Among the most costly aspects of complying with the proposal are the recordkeeping changes that would have to occur in order to classify, identify, and describe expenses by functional category; to assign staff and officer time by functional category; to train and allocate additional time

for staff and officers to keep records that meet the new requirements; to adapt existing hardware and software to fulfill the new requirements, and to pay for sufficient computer, accounting, and legal expertise. Each of these changes will impose substantial costs on both local and national/international unions.

One of the most significant facts that these numbers reveal is that local unions will bear a disproportionate financial burden under the proposal. As noted above, at least 97 percent of all LM-2 filers are local unions, some with revenues of as little as \$200,000 per year. In fact, a study by Professor John Lund at the University of Wisconsin School for Workers showed that almost 40 percent of all LM-2 filers have annual revenues of less than half a million dollars. Yet the average cost of compliance for local unions is over \$217,000.

What could possibly justify such a crushing burden? The practical implications are staggering. Imagine the local union that cannot process meritorious grievances to arbitration because it must spend the hard-earned dues money of its members on tracking each and every expense according to the Department's idiosyncratic accounting requirements. Imagine the local that cannot effectively conduct contract negotiations or engage in standard grievance handling because those costs have been trumped by LM-2 compliance? Imagine the union that cannot train its stewards in effective representation because government reporting costs have sapped the local's treasury. What better way to hobble thousands of local unions than by moving forward with a rule that prevents them from fulfilling their statutory responsibilities to their members in the name of democracy and transparency?

Interestingly, in response to an AFL-CIO Freedom of Information Act request to the Department, we received a copy of a February 1992 memorandum to then-Secretary of Labor Lynn Martin from then-Congressman Newt Gingrich, urging the Department to implement similar (though less onerous) changes to the LM reporting requirements. According to Representative Gingrich, such changes would "weaken our opponents and encourage our allies." How ironic that in launching such an attack on unions, those who support such changes in the LM reporting requirements would so easily sacrifice employees' rights to effective representation at the workplace.

THE DEPARTMENT'S PROPOSAL VIOLATES PRINCIPLES OF FUNDAMENTAL FAIRNESS

This leads me to my second point. Federal securities law does not subject the business community to a financial reporting regime nearly as onerous or costly as the one proposed by the Department for labor unions.

At the outset, bear in mind that the reporting requirements of the Securities and Exchange Act, enforced by the SEC, applies only to publicly-traded corporations. As a result, only approximately 10 percent of all U.S. companies are subject to such requirements. In fact, even some of the nation's largest companies—Mars, Bechtel, and Cargill, for example—have no reporting requirements whatsoever because they are privately-held.

Moreover, the Department's itemization requirement—which lies at the heart of its proposal and is the most onerous aspect of the new rule—has no parallel in the entire SEC scheme of corporate reporting. Under this requirement unions must report detailed information about every single disbursement that (alone or in the aggregate) reaches the low threshold of \$2,000 to \$5,000 to any single individual or entity in one of eight "functional categories." The only way to comply with the requirement is for unions to record these specific details about every single transaction in which they are engaged during the year. Our affiliates have provided detailed information to the Department in their comments about the untold record-keeping and reporting burden this would impose on them.

There is a very simple reason why corporations have no such parallel requirement. As Secretary Chao acknowledged in a recent letter to Subcommittee Chairman Specter, the reports that publicly-traded corporations have to file "must disclose 'material' financial information" only. What that letter did not reveal, however, is that disclosure of only such information as is deemed material is all that is required by Generally Accepted Accounting Principles (GAAP), which govern the way public, for-profit, and not-for-profit entities should report their finances. Under GAAP, the principle of materiality means that items that are too small to influence an individual's judgments about an entity's financial condition are routinely aggregated into meaningful categories. The Department's proposal, by contrast, would for the first time require unions to keep track of and report individually, in great detail, an overwhelming number of transactions without regard to their materiality. Under this proposal, the LMRDA would stand alone among federal financial reporting standards in failing to embrace universally accepted GAAP principles.

Why such a radical departure from principles that corporations—whether they are for-profit or non-profit—must follow under federal law? Secretary Chao's letter claims that the virtue of the Department's proposal is that it spares the regulated community—i.e., unions—of the task of deciding whether information is material or not. This is nothing more than a double standard designed to cripple unions with pointless recordkeeping and reporting requirements.

Our survey revealed that over 90 percent of national/international unions and 60 percent of locals have at least 1,000 or more disbursements annually. Over 40 percent of national/international unions and almost 20 percent of locals have 10,000 or more disbursements annually. They, like their corporate counterparts, are entitled to follow Generally Accepted Accounting Principles, which impose order, rationality, and cost/benefit justification on financial reporting. They, like their corporate counterparts, would far prefer to make whatever decisions are involved in determining materiality than to waste their financial and human resources in tracking the minutiae of useless information. And, like their corporate counterparts, they are entitled to get on with the work that they are entrusted by their constituents to perform. Saddling them with any greater burden has no justification under principles of fundamental fairness, good government, or responsible financial reporting.

THE DEPARTMENT'S PROPOSAL CANNOT ACCOMPLISH ITS INTENDED GOALS

My third and final concern flows inevitably from this last point. The Department's proposal will not accomplish its stated purposes of providing greater transparency to union members or deterring fraud and embezzlement. The Department claims that the current LM-2 form generates "large dollar amount[s] and vague description[s] . . . that make it essentially impossible for members to determine whether or not their dues were spent properly." 67 Fed. Reg. at 79282. However, under no circumstances will the proposal result in more useful reporting.

To be sure, the Department's proposal will generate thousands of lines of "data" per union, each one showing an individual disbursement during the accounting year, in chronological order, in eight separate categories. A union that has a modest 8,000 transactions per year would file an LM-2 report that could cover as many as 1,500 pages. A mid-sized union with 13,000 transactions would file a 2,200-page report. A large international union with 150,000 disbursements would file a 25,000-page report. But we all know that volume and transparency are not the same. Without meaningful aggregation of data, and eliminating immaterial information, union members will wind up with reams of paper containing the most detailed, often confusing information that they have neither the time nor the expertise to decipher.

Such enormous masses of data do nothing to simplify, condense or aggregate financial information into meaningful totals that unions' members could use to understand the financial status of their union. Rather, the proposed forms would simply disclose massive amounts of non-material financial data, with the result that union members are more likely to be frustrated and deterred in their efforts to glean any meaningful information from the form.

The Department's claim that providing such minute and detailed data to union members "will enable them to be responsible and effective participants in the democratic governance of their unions" (67 Fed. Reg. at 79281) is absurd on its face. If the Department were genuinely concerned that the current reporting system resulted in vague descriptions that did not permit union members to know how their dues are spent, then it would have proposed that unions aggregate their disbursements into more meaningful categories. This is the solution dictated by GAAP and that every other financial reporting system relied on by the federal government has adopted.

If union members would not benefit from the proposed disclosure scheme who would? We think the answer to that is obvious. Anti-union organizations who have the research capability to comb through the union's LM-2's and analyze the data would reap an enormous windfall. In essence, they would gain access over the Internet—since the Department will publish these forms on-line—to over 5,000 labor organizations' general ledgers. Employers would gain access to a myriad of confidential information about a union's bargaining strategy and organizing activities. Imagine a company having to post its entire ledger on the web in order to comply with government financial reporting requirements in the name of transparency.

The Department also claims—although it provides no evidence whatsoever to support this claim—that the revised reporting requirements will deter corruption and financial mismanagement because "more detailed reporting of all financial transactions . . . would [make it] . . . more difficult to hide financial mismanagement from members." 67 Fed. Reg. at 79291. But DOL itself has starkly described the limits of deterrence that detailed reporting can provide. In a letter from Deputy

Assistant Secretary for Labor Management Standards Don Todd to Representative Charles Norwood, Mr. Todd made this observation:

“[I]t is often difficult to detect financial corruption or mismanagement from a reporting form, no matter what disclosure is required, since the perpetrators will often attempt to conceal illegal and improper actions.”

The Department’s deterrence claim is not only unsupported in the proposal itself, but it cannot be justified. First, it does not take much to realize that the Department’s proposal would provide those engaged in fraud with thousands of minute transactions in which to bury illegal transactions. Thus, there is nothing in the accounting literature to support the notion that itemization deters corruption. Rather, that literature makes plain that verification of the reliability of financial statements is provided through the well-established system of outside auditing. Auditors are highly trained professionals who know how to verify that allocations are properly made and that organizations have adequate internal controls to ensure that corruption cannot take root.

When auditors fail to carry out this role faithfully in the for-profit sector—as happened with Enron—no one suggests that for-profit entities should itemize their disbursements and receipts as a way to deter corruption. Instead, reform efforts focus on fixing the private auditing system to ensure that it works the way it is supposed to. Thus, legislation was passed in response to Enron that establishes more federal oversight on auditing standards, that limits opportunities for auditor conflicts of interest, and that sets rules for internal audit committees in those for-profit corporations that choose to avail themselves of the public securities markets. *See* Sarbanes-Oxley Act of 2002, Public Law No. 107–204, 116 Stat. 745 (2002).

Similarly, many federal statutes rely on the private auditing system to deter corruption and financial mismanagement. Two examples illustrate this point:

- when Congress sought to assure that federal awards to state and local governments and not-for-profits are properly spent, it dictated that specific auditing standards be developed for private auditors. (*See* Audits of States, Local governments, and Not-for-Profit Organizations Receiving Federal Awards, Statement of Position No. 98–3 (American Inst. Of Certified Public Accountants);
- Under Section 302 of the Labor-Management Relations Act, 29 U.S.C. § 186, there is a general exception to the rule against employer payments to union representatives or labor organizations, where such payments are made into a trust fund that, among other requirements, contains a provision for an annual audit to be made available for inspection by interested persons.

Lastly, in agency fee cases, the United States Supreme Court has recognized the centrality of private audits in shaping labor organization disclosure requirements. Even though what is at stake in the agency fee context is nonmembers’ constitutional right to avoid subsidizing political activities to which they object, the Court specifically rejected the argument that unions should have to disclose itemized lists of individual disbursements—instead holding that an audit should be the mechanism to provide assurance of the accuracy of a union’s allocations between categories of chargeable and nonchargeable expenditures:

“The union need not provide nonmembers with an exhaustive *and detailed list of all its expenditures*, but adequate disclosure surely would include the major categories of expenses, as well as *verification by an independent auditor*.”—*Chicago Teachers Union Local No. 1 v. Hudson*, 475 U.S. 292, 307 n.18 (1986) (emphasis added).

CONCLUSION

I want to reiterate the AFL–CIO’s longstanding support for the LMRDA. Our commitment to the principles behind the Act remains as firm today as it was some forty-four years ago when it was passed. We support disclosure that provides meaningful and useful financial information to union members in aid of union democracy and fiscal accountability. And, to the extent that there are rational, cost-effective ways to improve current disclosure requirements for unions, we would support such changes.

Nevertheless, any changes to the current rules must fit within the bounds of the statute and be consistent with the carefully constructed system of accounting standards to which unions are already subject. Any changes should demonstrably improve the quality of the information reported, and should not be unduly burdensome to unions or undermine their ability to conduct their activities on behalf of their members. In furtherance of such improvements, the AFL–CIO and its affiliates have indicated their willingness to work with the Department to explore a requirement that LM–2 filers, at both the national and local level, would undergo an independent

audit each year by a certified public accountant, tailored to their size and resources. Such an approach would potentially provide much more meaningful information to union members and also provide a much truer test of the integrity of their unions' financial accounting systems.

In contrast, as I have discussed, the Department's proposal fails in numerous and substantial respects to meet any of the well-accepted accounting and auditing standards that are the prerequisites to meaningful and rational financial reporting. And, at the same time, the proposal singles out unions to shoulder an astronomical compliance burden. We hope you will urge the Department to withdraw its proposal.

Thank you for the opportunity to comment on this important matter.

STATEMENT OF JAY COCHRAN, Ph.D., RESEARCH FELLOW, MERCATUS CENTER, GEORGE MASON UNIVERSITY

Senator SPECTER. Thank you very much, Mr. Hiatt. Our next witness is Mr. Jay Cochran, a research fellow in regulatory studies at the Mercatus Center at George Mason University. Mr. Cochran has a bachelor's and master's degree from Virginia Polytech and a master's and Ph.D. from George Mason University. Thank you for joining us, Mr. Cochran, and we look forward to your testimony.

Dr. COCHRAN. Good afternoon, Mr. Chairman, Mr. Harkin, members of the committee, ladies and gentlemen. Thank you for the opportunity to comment today on the Labor Department's proposed rule regarding labor organization annual financial reports.

I am Jay Cochran, a research fellow in regulatory studies at the Mercatus Center at George Mason University and an adjunct professor of economics at GMU. Our mission at the regulatory studies program is to advance knowledge of the impact of regulations on society by conducting careful, independent analyses using contemporary economic scholarship to assess rulemaking proposals from the perspective of the public interest. Thus, the work we do does not represent the views of any particular affected party or special interest group, but rather is designed to evaluate rulemaking proposals from the perspective of their effect on overall consumer welfare. I would like to emphasize, Mr. Chairman, that the views that I express today are my own and do not reflect an official position of the university.

In February of this year, I authored a public interest comment on the Labor Department's proposed union financial reports rule. Mr. Chairman, I respectfully request that those formal comments on the rule be incorporated into the hearing record as part of my remarks here today.

Senator SPECTER. Without objection, they will be made a part of the record.

[The information follows:]

REGULATORY STUDIES PROGRAM

PUBLIC INTEREST COMMENT ON LABOR ORGANIZATION ANNUAL FINANCIAL DISCLOSURE REPORTS; PROPOSED RULE¹

The Regulatory Studies Program (RSP) of the Mercatus Center at George Mason University is dedicated to advancing knowledge of the impact of regulation on society. As part of its mission, RSP conducts careful and independent analyses employing contemporary economic scholarship to assess rulemaking proposals from the perspective of the public interest. Thus, this comment on the Department of Labor's

¹Prepared by Jay Cochran, Research Fellow, Regulatory Studies Program. This comment is one in a series of Public Interest Comments from Mercatus Center's Regulatory Studies Program and does not represent an official position of George Mason University.

proposed rule, *Labor Organization Annual Financial Disclosure Reports*,² does not represent the views of any particular affected party or special interest group, but is designed to evaluate the effect of the Department's proposals on overall consumer welfare.

This comment is organized such that Section I provides a brief introduction to the proposed rule. Section II provides some economic background to the rule and our analysis of it. Section III reviews the main benefits ascribed to the proposed rule. Section IV discusses the cost estimates developed by the Department, while Section V provides an alternative estimate of rule-associated costs. Section VI provides various benchmarks against which the cost estimates can be compared and placed into a larger context.

I. INTRODUCTION

Under the *Labor-Management Reporting and Disclosure Act of 1959* (or, the "Landrum-Griffin Act"), the Employment Standards Administration (ESA) within the Department of Labor is seeking to reform the financial disclosure requirements applicable to organized labor. The Department's purpose in reforming the reporting requirements applicable to labor organizations is "to improve the transparency and accountability of labor organizations to their members, the public, and the government; to increase the information available to members of labor organizations, and to make the data disclosed in such reports more understandable and accessible."³

More than forty years have passed since enactment of the Landrum-Griffin Act, and only once in that time have the reporting procedures applicable to organized labor undergone any appreciable change.⁴ The Department suggests it may once again be time to reform reporting requirements, especially in light of the myriad technological changes affecting both organized labor in general and financial reporting in particular.

Some of the reforms the Department seeks under the proposed rule include: (a) an electronic filing requirement for labor organizations reporting financial disclosures using Form LM-2;⁵ (b) identification of "major" receipts and disbursements; and (c) reporting of assets, liabilities, receipts, and disbursements of organizations with annual receipts of \$200,000 or more that meet the statutory definition of a "trust in which a labor organization is interested."⁶

Before discussing the specific benefits and costs of the Department's proposed rules, we provide some basic background on the economics of organized labor. Doing so will establish an important contextual foundation for the remainder of our comment on the proposed rule.

II. ECONOMIC BACKGROUND

Normally, when an executive branch agency considers the implementation of a new regulation, our first question asks whether a significant market failure exists that merits federal regulatory attention.⁷ Clearly, such an argument cannot be advanced in the present case. The most one can claim is that a regulatory or government failure exists, and that the present regulation is an attempt to remedy part of that failure. This conclusion rests on and results from the basic political economy of organized labor.

Unions are customarily treated in microeconomic theory as monopoly suppliers of labor in a particular industry or trade, with the attendant reduction in labor supply and increase in wage rates characteristic of a typical industrial monopoly. The pre-

²See, "Labor Organization Annual Financial Disclosure Reports; Proposed Rule," *Federal Register* 67 (249), pp. 79280-79414. Hereafter referred to as the "proposed rule."

³*ibid.*, p. 79280.

⁴Late in 1992, changes to union reporting requirements were implemented that increased the classification detail of disbursements. This rule, however, was rescinded in December 1993.

⁵According to the Department, Form LM-2 currently applies to labor organizations with \$200,000 or more in annual receipts (p. 79290). The Department estimates that Form LM-2, therefore, applies to 5,514 labor organizations. An additional 21,398 other labor organizations fall below this \$200,000 threshold and will have to file the simpler LM-3 or LM-4 forms. Another 3,551 "trusts" or organizations or funds held by multiple labor organizations will be required to file a modified form T-1. (See also Table 2, p. 79297.)

⁶*ibid.*, p. 79280.

⁷See the Mercatus Center Regulatory Checklist, where we ask whether (i) a market failure has been identified by the regulating agency; (ii) a federal role has been appropriately established; (iii) the agency examined alternative approaches; (iv) the agency attempted to maximize net benefits; (v) there is a strong scientific or technical basis for the regulation; (vi) the distributional effects are clearly understood; and (vii) individual choices and property impacts are clearly understood. The checklist has been applied to the present rule, and the results of that evaluation are attached in an Appendix to this comment.

cise combination of wage rate increases and labor supply reductions remains a function of union goals (e.g., maximized union employment, capture of economic rents, or maximization of total union wage payments, for example).⁸ It is crucial to recall, however, that the monopoly position enjoyed by organized labor in the United States today is not a “natural” monopoly in the economic sense of that term, but rather arises from the various privileges and immunities awarded and protected by the federal government since about the time of the New Deal.⁹

It is therefore difficult to make the case that the labor market has failed in any substantive sense with respect to organized labor given that it has not been allowed to function without impediment. Rather what we are presented with in the current set of regulations is an effort to curb the more egregious financial practices of some unions—practices that have emerged, in part, by virtue of their specially protected status. In other words, the present set of regulations attempts to correct and control abuses stemming from a previous set of laws and regulations that distorted the operation of the labor market and in effect opened the door to such abuses in the first place.

It is perhaps unreasonable, therefore, to expect this set of regulations for enhanced financial disclosure to achieve its intended aim, since the problem is not with financial disclosure per se, but rather with the market distortions created by government interference in the labor market. Nevertheless, this should not be taken as disparaging the effort entirely; inasmuch as if the latter path (i.e., restoration of free contract in labor) is not currently a viable option, then curbing the more egregious abuses attendant with monopoly labor supply may be a second-best course of action.

The specific problem the present regulation attempts to remedy is a variant of the principal-agent problem: in particular, an information asymmetry between the principal (labor) and his/her agent (union officials). This asymmetry emerges largely because the usual set of market checks and balances has been attenuated in the case of organized labor.¹⁰ Under present disclosure standards, it is difficult, and in some cases impossible, for the principals to know the applications to which union funds and other resources have been put, due to the opaque and infrequent nature of union financial disclosure statements.

Without meaningful external checks on an agent’s financial decisions afforded by vigorous market competition for resources (including membership), it becomes easier to understand the increased frequency of self-dealing, embezzlement, or other prob-

⁸In this connection, see, for example, Walter Nicholson (1995), *Microeconomic Theory Sixth Edition*, New York: Dryden Press, pp. 753–757, or Richard Posner (1984), “Some Economics of Labor Law,” *University of Chicago Law Review* 51: pp. 988–1011.

⁹See, for example, Morgan Reynolds (1987), *Making America Poorer: The Cost of Labor Law*, Washington, D.C.: Cato Institute, pp. 15–25. Reynolds draws a useful distinction between privileges (i.e., special rights conferred on organized labor that are unavailable to other members of U.S. society), and immunities (i.e., actual exemptions from law that are similarly unavailable to others in the United States.). *The National Labor Relations Act of 1935* (“Wagner Act”), for example, provides that employers must bargain in “good faith” with “duly elected” union representatives. Union representatives, in turn, may require compulsory dues payments from non-members, and may provide collective representation to those who wish no such representation. The Wagner Act in effect gives unions the privilege of representing both those who wish to be so represented as well as those who do not wish such representation and to collect dues from both parties.

By contrast, the Clayton Act of 1914 and the *Anti-Injunction Act of 1932* (“Norris-LaGuardia Act”) exempt unions from antitrust laws, immunize them against federal court injunctions, and grant immunity from private civil damage suits. In addition, the *Anti-Racketeering Act of 1934* specifically exempted unions from anti-racketeering laws. (The Hobbs Amendment attempted to overcome this exemption, but was unsuccessful on subsequent Court challenge, when the U.S. Supreme Court upheld the use of union violence to achieve legitimate labor goals, saying, “the [Hobbs] Act does not apply to the use of force to achieve legitimate labor ends”—as quoted in Reynolds [1987, p. 23].)

Lastly, to curtail some of the unintended consequences of pro-labor legislation, Congress sought to reign in organized labor through the *Labor-Management Relations Act of 1947* (“Taft-Hartley Act”) and the *Labor-Management Reporting and Disclosure Act of 1959* (“Landrum-Griffin Act”). As Reynolds (1987, p. 21) points out, shortly after the passage of the Wagner Act, “Government regulation expanded to deal with some of the effects of union power, largely created by privileges and immunities.” Expansion of the regulatory requirements on organized labor under the Landrum-Griffin Act, in fact, is the subject of the present set of regulations.

¹⁰That is, because of the privileges granted by U.S. labor laws, such as compulsory collective bargaining and representation, a union does not have to compete for its membership or income stream. Because of the immunities that unions enjoy, organized labor does not have to rise to the same standards of conduct as other members and institutions of U.S. society.

lems that have checkered the history of organized labor.¹¹ Such undesirable behavior need not, however, be the case. Controls to prevent or uncover financial abuses can arise out of the natural operation of market competition for resources or, failing that course, can be brought about through the deliberate design and application of regulations.¹²

III. BENEFITS ATTRIBUTED TO THE RULE

The Department lists three main benefits from the reform of union financial disclosures:

- Better reporting will allow union members to make better decisions about the governance of their unions.¹³
- More-detailed financial reporting will make it more difficult to hide fraud.¹⁴
- More-detailed reporting will provide an effective deterrent to financial mismanagement.¹⁵

A. *More-Informed Governance Decisions*

To be sure, more disclosure has the potential for union members to make more informed decisions about their union. However, the Department may be making an overly strong benefit claim when it states, “If the members of labor organizations had more complete, understandable information about their unions’ financial transactions, investments, and solvency, they would be in a much better position than they are today to protect their personal financial interests and exercise their democratic rights of self-governance.”¹⁶

This unqualified statement can be incorrect if union members suffer from other impediments to effective action beyond a simple lack of information. Indeed, just having more information may not necessarily be beneficial by itself if individuals, for example, bear concentrated costs of taking action arising from their evaluation of financial information, while the benefits accruing from such action remain dispersed among the union membership as a whole.¹⁷ If concentrated personal costs and dispersed benefits exist, then it does not follow that individual union members will automatically be in any better position today from increased disclosure.

It is important to stress, however, that this line of reasoning does not argue against increased disclosure and improved transparency. Increased disclosure is more likely than less disclosure to bring about improved transparency; however, it will not automatically do so, and overly strong benefit claims may not advance the case for improved disclosure in any event.

B. *More-Detailed Financial Reporting Will Make it More Difficult to Hide Fraud*

We concur with the Department’s assessment that in comparison to the current reporting requirements on labor organizations, more detailed financial reporting will tend to raise the cost of hiding fraud. By increasing the number of classification cat-

¹¹This is not to suggest either that such temptations do not occur when competition is vigorous. They do. The point, however, is that such problems tend to be caught more quickly, and the damages that result are contained more efficiently under competition than without it.

¹²The regulatory approach is necessarily a second-best alternative since it is impossible to design a regulatory apparatus that foresees every eventuality, and because those subject to regulation innovate along non-regulated dimensions as well as in the necessarily “grey areas” of any rule.

¹³The Department and ESA suggest that increasing the volume of financial disclosures made by labor organizations will provide “union members with useful data that will enable them to be responsible and effective participants in the democratic governance of their unions.” (p. 79281)

¹⁴The Department suggests “the broad aggregated categories on the existing forms made it possible to hide embezzlements, self-dealing, overspending, and financial mismanagement.” (p. 79282)

¹⁵“ . . . detailed reporting can be an effective deterrent, and that more detail throughout the form LM-2 would further discourage malfeasance.” (p. 79282)

¹⁶Proposed Rule, pp. 79280–79281.

¹⁷It is possible, for example, to imagine a case where a union member—through her own analysis of union finances, made possible by the proposed regulation—uncovers financial mismanagement. However, because of intimidation (physical violence or threats of same), she has to bear substantial personal costs unless she remains quiet. If, on the other hand, she successfully pursues her discovery, the benefits of better union management will be bestowed not just on her, but also on all the members of her union.

This example should not be taken as arguing that union members should or should not pursue discoveries of mismanagement as and when they find them, nor that enhanced disclosure should not be in place to facilitate such potential discoveries. Rather its purpose is merely to illustrate the concept of concentrated costs and dispersed benefits, and how such a situation can present a barrier to acting on information that will not always be solved by the provision of more information.

egories, lowering the dollar level of disclosures, and by potentially increasing the number of people who must participate in a potential fraud, the revised reports sought by ESA and the Department should make committing fraud more costly than it is under current disclosure rules.

C. More-Detailed Reporting Will Provide an Effective Deterrent to Financial Mismanagement

Since more-detailed financial reporting is likely to raise the cost of committing fraud, less financial mismanagement can be a likely outcome, other things being equal. This result occurs because the potentially dishonest respond to incentives just as the honest do, and therefore by raising the cost of committing fraud, one can reasonably expect to see less of it. Despite this basic economic relationship, however, we would hasten to add that deterrence per se, is not simply a matter of increased or more-detailed disclosures. Rather, it can be argued that disclosure is instead a necessary but insufficient precondition for effective discovery and deterrence of financial mismanagement.

The Department seems implicitly to understand that a more involved process of deterrence operates than simply more-detailed reporting. In the proposed rule, it cites a recent case in which “the lack of supporting detail [on expenditures] enabled [union] officials to hide in excess of \$1.5 million in personal dining, drinking and entertainment expenses from 1992 to 1999.”¹⁸ The important attribute to consider in this case, though, is not that certain officials hid their misappropriation of funds, but rather that it was a Departmental investigation that uncovered the fraud, and that this discovery, moreover, occurred within the current environment of comparatively poor disclosure.

In other words, actual deterrence of financial mismanagement is more difficult in an organized labor setting than in a comparable competitive setting for reasons outlined earlier, and because fewer checks on the financial performance of unions occur on a regular basis. This means improved financial disclosure is an important component of the overall deterrent process, but it is not all. We would add that examinations of financial data by interested parties (union members, journalists, citizens, etc.); regular audits by disinterested accounting professionals; and periodic investigations by appropriate Department personnel are other important tools that complement and complete any enhanced disclosure process aimed at deterring financial mismanagement.

1. Disclosure Thresholds

To enhance the disclosure process and to deter mismanagement, the Department establishes minimum disclosure standards for various balance sheet and income statement items.¹⁹ At several places throughout the proposed rule, the Department asks for comment on whether these specifically proposed dollar thresholds of disclosure are set at appropriate levels. Given the operational peculiarities of individual unions as well as their wide disparity in sizes, it is probably impossible to determine an appropriate level of disclosure for all unions under all circumstances.

To resolve the threshold issue while still recognizing the likelihood of important differences among the various unions, we suggest that the Department may wish to consider implementing a disclosure standard based on whether an outside observer (i.e., a reasonable person unconnected with the union) would consider a given disclosure material to an accurate understanding of a labor organization’s financial position. Implementing a materiality standard (similar to the standard that exists with regard to corporate disclosure and auditing standards) helps to resolve the Department’s issues with respect to absolute disclosure levels.

Admittedly, a materiality standard introduces an element of judgment in the reporting process and has the potential to complicate the investigative process. However, such tradeoffs seem no worse than establishing what are in fact arbitrary re-

¹⁸ Proposed Rule, p. 79282.

¹⁹ The new LM-2 for example, requires attachment of an accounts receivable aging schedule recording any individual or entity from which more than \$1,000 is due. A similar schedule (and threshold) is applied to accounts payable. All investments with a market value of at least \$5,000 (or representing more than 5 percent of the total market value of all investments) must be reported on a separate schedule to the LM-2. Similarly, disbursements to employees totaling more than \$10,000 in a reporting period, and all disbursement to officers must be documented in attachments to the required filings. Receipts and disbursements to any individual or entity totaling more than \$5,000 during the reporting must also be separately reported. See the Proposed Rule, p. 79285–79289.

porting thresholds and then applying those thresholds in a one-size-fits-all fashion to every labor organization.²⁰

IV. DEPARTMENT COST ESTIMATES OF THE PROPOSED RULE

The Department estimates that the proposed changes to the four financial disclosure forms (LM-2, LM-3, LM-4, and T-1) will be \$17.8 million in the first year, \$5.8 million in year two, and \$5.3 million in year three.²¹ These costs result from increased recordkeeping and reporting burdens, software changes, training and so on, that the unions will incur in order to comply with the proposed rule. In addition, the Department estimates that the Federal government will incur incremental equipment, personnel, and overhead expenses of \$7.2 million per year in connection with implementing and overseeing the new rule.²² Below we offer comments on the Department's estimates.

A. *Very Precise Burden-Hour Estimates*

We congratulate the Department for being able to make such precise burden-hour estimates for over 26,000 unions and over 3,000 trusts. However, precision carried out to two decimal places does lead one to wonder whether it is reasonable to assume that the 8,108 unions filing form LM-4, for example, will incur precisely 0.03 hours (or 1.8 minutes) of on-going recordkeeping burden in connection with the rule.²³

We would suggest in the alternative that if the actual incremental burden is negligible, then zero should be used. If, however, there is expected to be some non-trivial increase in on-going recordkeeping burden, more defensible estimates would consider making allowances for error and correction, for personnel time to recall proper classifications, and so on. In other words, additional recordkeeping rules mean that those responsible for implementing such rules may be likely to incur additional, non-trivial amounts of time in on-going recordkeeping procedures if such recording is to be undertaken accurately.

Perhaps just as important in this connection is the recognition that on-going recordkeeping functions with respect to the new requirements are likely to exist beyond the confines of a union's accounting department. Thus, for example, when a union organizer hosts an educational program and then seeks reimbursement for her expenses, she will have to consider and follow the rule's requirements pertaining to documentation, record retention, appropriate expense classification, and so on (and the new rules are likely to be different from and more complicated than the rules she has been accustomed to observing).²⁴ Such burdens, though perhaps small for any given accounting event, and likely to be dispersed across many people throughout an organization, nevertheless seem unlikely to be as small in the aggregate as the Department suggests in its recordkeeping burden estimates for the various forms.

In the alternative estimates we provide below, we have used small (though non-trivial) hourly estimates for on-going recordkeeping burdens. With respect to burden estimates more generally, we have chosen to provide round figures (typically rounded to nearest half working day) rather than very precise estimates. The rationale for such an approach is to produce cost estimates that are defensible in general magnitude rather than in particular exactitude.

B. *Inconsistent Cost/Burden Hour Applied*

Laying aside the issue of burden-hour estimate precision, and taking the total burden hours estimated by the department at face value, we are still left with the application of inconsistent dollar costs per hour to the burden-hour estimates them-

²⁰ It is possible also to address (at least partly) a one-size-fits-all criticism to disclosure thresholds by assigning differing thresholds based on union size (using assets, receipts, membership, or other appropriate measures). Doing so lifts the judgment burden regarding disclosures that exists under a materiality standard from the unions and places it on the Department. In addition, a disclosure threshold that varies with union size reflects an acknowledgment that there are likely to be important differences among unions as to what constitutes a material disbursement, investment, accounts receivable and so on.

In sum, an explicit regulatory threshold places an ex ante judgment burden on the regulators to establish appropriate thresholds that are neither too rigid nor too lax. A materiality threshold, by contrast, places an ex post judgment burden on the disclosing union and its auditors.

²¹ Proposed Rule, p. 79293.

²² *Loc. cit.*

²³ Proposed Rule, Table 2, p. 79297.

²⁴ The new rules might suggest that such costs are learning curve related and thus unlikely to recur once the learning is completed. While there is, no doubt, some truth to that assertion, it also seems equally likely that a changed institutional environment is likely to involve changes of permanent nature.

selves. For example, the Department estimates that the new LM-2 form will entail total reporting and recordkeeping burdens of 579,135 hours. Dividing this figure into the Department's total cost estimate for the LM-2 form (\$14.618 million) yields an hourly cost of \$25.24. Similar calculations for the LM-3, LM-4, and T-1 forms yield per hour cost estimates of \$20.36, \$24.79, and \$26.61 respectively.²⁵

In its description of the burden estimates, the Department suggests that little beyond incremental labor will be required by the unions to comply with the new disclosure requirements.²⁶ If this is true, then the hourly rates used to monetize the hourly burden estimates, arguably, should be more consistent. In our cost estimates, presented below, we have applied instead an hourly labor rate of \$27.80, which represents the fully loaded hourly wage rate of union employees in the United States.²⁷

C. Little Documentation of the Government's Own Incremental Costs

The Department estimates that incremental costs to the federal government of changing the reporting requirements for unions are \$7.187 million per year. It suggests that this estimate "includes operational expenses such as equipment, overhead, and printing, as well as salaries and benefits for the OLMS staff in the National Office and field offices that are involved with reporting and disclosure activities. The estimate also includes the annualized cost for redesigning the forms, developing and implementing the electronic software, and implementing digital signature capability."²⁸ Without any supporting documentation or detail of the data included in the Department's estimate, it is impossible to validate this figure, or to offer an alternative estimate. In our alternative estimates (see below), we have simply adopted the Department's estimates of incremental governmental expenses related to the rule.

D. No Capitalization of Cost Estimates Provided

Although the Department displays a high level of precision in developing its compliance burden estimates, nowhere does it capitalize the cost estimates that it does generate. The sum of the discounted present value of all the cost streams is important so that the proposed rule can be evaluated against other alternatives with potentially different time dimensions as well as to give policymakers an indication of the total lifetime costs of a particular rule.

Capitalizing the Department's annual cost estimates, using the OMB-suggested discount rate of seven percent, produces an estimated lifetime cost of the rule of \$212.5 million.²⁹ About \$103 million of this figure represents capitalized government-incurred costs of the rule, while the remaining \$110 million represents the long-run compliance costs incurred by the labor organizations themselves.

V. ALTERNATIVE COST ESTIMATES OF THE PROPOSED RULE

Appendix I details the sources and methods used to estimate the costs of the Labor Department's enhanced financial disclosure regulation. In short, however, it is estimated that the lifetime cost of the rule will be roughly \$298 million, including the incremental costs to the government to administer and enforce the new standards. Capitalizing the up-front and annually recurring costs using OMB's recommended 7 percent discount rate produced this estimate.

²⁵The hourly rates also change without explanation for subsequent year estimates for forms LM-2 and T-1.

²⁶In calculating the burden for form LM-2, for example, "the Department carefully considered the amount of time it takes to: (a) Read the reporting instructions; (b) gather the books and records to respond to various reporting requirements; (c) organize the books and records to respond to various reporting requirements; (d) complete the form; and (e) check the responses." (Proposed Rule, p. 79294) This suggests the burden-hour estimates consist almost entirely of labor hours. This perception is further reinforced when the Department states, ". . . any capital investment including computers and software that are usual and customary expenses incurred by persons in the normal course of their business are excluded from the regulatory definition of burden." (Proposed Rule, p. 79294)

²⁷This figure includes wage and salary payments, fringe benefits, as well as Social Security, unemployment insurance, and workers compensation payment paid on behalf of a union employee. Source: Statistical Abstract of the United States (2001), Table 626, "Employer Costs for Employee Compensation per Hour Worked: 2001," p. 406. Union data taken from column 6 of Table 626.

²⁸Proposed Rule, p. 79296.

²⁹We applied the 7 percent discount rate assuming that the first year's compliance costs would be back-end loaded; that is, incurred mostly toward the end of the first year in which the rule was applicable. Thus, the first year's costs are not discounted, while the second year's costs are discounted one period. Third and subsequent year's costs were then assumed to recur. To arrive at a capitalized cost for these out-year estimates, the recurring costs were first annuitized back to the third year, and then the annuitized sum was discounted back for two periods at the seven percent rate.

In the first year of application, the revised form LM-2, LM-3, LM-4, and T-1 are estimated to result in compliance costs of \$63.3 million for the more than 26,000 affected labor unions and 3,500 labor-related trusts in the United States. In the second year, estimated total compliance costs are expected to decline to \$19.9 million, while costs in the third and succeeding years are expected to total \$9.0 million each year. With respect to incremental cost of administration and enforcement for the federal government, we adopted the estimates made by the Department of \$7.2 million per year.

A. Differences Explained

The two main areas that account for the difference between our estimates and the Department's are (1) the number of hours for reporting and record keeping expected to be incurred by the average union organization, and (2) the application of a consistent (and higher) labor rate per hour. The change in the number of hours estimated for reporting and recording keeping (mostly in form of rounding and more generous allowances for initial compliance) accounted for roughly three-fourths of the deviation between our estimate and the Department's. The remaining one-quarter of the difference can be accounted for by the application of a standardized labor-hour rate. We believe these adjustments provide a more generous estimate of both burden hours and costs likely to be incurred by the affected labor organizations.

B. Average Cost per Union

The Department estimates that 26,912 unions and 3,551 labor trusts will be affected by the changed financial disclosure regulations. Based on our estimates of lifetime costs to the unions (and ignoring incremental costs to the federal government), the average union will bear a cost of approximately \$4,715 to comply with the new disclosure requirements, while the average labor-related trust will bear a long-run cost of \$19,035 to comply.

Averages can be misleading since they can obscure large variances among the different organizations. This suggests costs may be disproportionately higher for larger unions. However, averages are supplied so that some standardized comparisons can be made to other organizations that disclose financial information on a regular basis.

VI. COST ESTIMATE CONTEXT

This section provides several different ways to put the various compliance cost estimates of the rule into context.

A. Comparison to Union Estimates

The long-run cost estimates provided in this comment were about 40 percent higher than a capitalized version of the Department's estimates. Our estimates, however, remain at the low end of published reports of cost estimates made by union representatives. Laurence Gold, associate general counsel to the AFL-CIO suggested, for example, in a recent Associated Press story "the accounting and record-keeping changes could cost unions \$250 million to \$1 billion."³⁰

Observing that there are 26,912 unions and 3,551 trusts covered by the new rule,³¹ the average compliance cost—using the AFL-CIO's estimates—ranges from about \$8,200 to just under \$33,000 per covered labor organization.

B. Comparisons to Corporate Disclosure Costs

Comparing the unions' disclosure costs to the costs incurred by other agents as they report to their principals provides another means of putting the rule's compliance costs into context. U.S. corporate managers (agents), for instance, regularly disclose their financial performances to shareholders (principals) through corporate annual reports, among other means. In calendar year 2001, it is estimated that the 12,000 public corporations in the United States communicated with their shareholders through corporate annual reports at a cost of slightly more than \$9.0 billion.³² These annual report production and distribution costs represented an aver-

³⁰ Leigh Strope, "Proposed Regulations Would Require Unions To Open Books, Report More Financial Detail," Associated Press, Washington, December 21, 2002. It was unclear from the AP story whether Mr. Gold was referring to annually recurring costs or lifetime costs of the rule. Given the context of the other estimates herein, the latter case seems more likely.

³¹ See Table 2, Proposed Rule, p. 79297.

³² Glenn Hasek (1997), "Adding Art to Numbers: Corporate Annual Reports," *Industry Week* 246: 21, p. 122. In this article Hasek cites Sid Cato, publisher of the *Newsletter on Annual Reports*, who states "more than 12,000 U.S. companies generated an average 232,000 copies of annual reports for 1996 at a cost of approximately \$3 per copy." Mr. Cato updated his estimate for 2001 in a news release stating "that average per-copy investment in 2001 annual [reports]

age disclosure cost per corporation of slightly more than \$750,000 in 2001, or about 23 times more than the AFL-CIO's own worst-case cost estimate.

C. Cost per Union Member of Enhanced Disclosure

The capitalized Department-estimated cost of the detailed financial disclosure (or \$110 million, which excludes the additional \$103 million of federal government costs for implementation and enforcement) represents an average cost of \$6.15 per union member.³³ By comparison, our cost estimates yield an average long-run cost of \$10.88 per member. Even using the AFL-CIO's high-end estimate of \$1.0 billion produces a cost estimate for more detailed disclosure of \$55.94 per union member (while its low-end estimate works out to an average cost per member of \$13.99).

Regardless of which estimate proves closest to being correct, the decision of whether or not this cost provides a positive value to individual union members is a question only individual members can answer. However, we can say that given our estimate of lifetime costs for enhanced disclosure represents about 24 minutes of the average U.S. union member's hourly pay rate, many may consider it bargain—but only if the new rules deliver the benefits the Department suggests they will.

D. Compliance Costs in Relation to Union Receipts

A sampling of union receipts (from dues, services, etc.) per union member can also help to put the rule's estimated compliance in perspective. Consider, for instance, that the Auto Workers Union (AFL-CIO) as of December 2001 reported on its LM-2 form that it had 701,818 members and total receipts of \$328.7 million, or roughly \$468 in receipts per member that year.³⁴ Even if the worst case prevailed and compliance costs totaled \$1 billion, resulting in average compliance costs of \$55.44 per union member, that would still represent about 12 percent of 1 year's UAW average, per-member receipts. On the other hand, if our estimates or the Department's are closer to the mark, the lifetime costs of the rule would equate to roughly 2 percent of average per member receipts for the Auto Workers' Union in 2001.³⁵

APPENDIX I.—COST ESTIMATES OF THE DEPARTMENT OF LABOR'S PROPOSED LABOR ORGANIZATION FINANCIAL DISCLOSURE RULE

I. COMPLIANCE BURDEN ESTIMATES

Form LM-2 involved the most significant changes and increases in supporting data to be provided. In the estimates that follow, our general procedure was to opt for burden estimates rounded to the nearest half working day, under the assumption that general orders of magnitude rather than precision are the best estimating outcome that one can hope to achieve. In addition, our estimates do not include any burden or cost estimates for legal oversight such as legal review of the regulation's applicability or subsequent compliance assurance before filing.

was \$3.24 . . .” From a news release dated November 1, 2002, taken from <http://www.sidcato.com/news/2002/rel1102.html>. These per-copy figures include printing and distribution costs, but not other costs such as executive and employee preparation time, related capital investments, etc.

³³ As stated above, the Department did not capitalize its cost estimates. Therefore, we capitalized their estimates by applying OMB's suggested 7 percent discount rate to the various estimates of annual costs. Estimates of third year costs were treated as subsequently recurring into the indefinite future. The bulk of first year costs were treated as having been incurred near the end of first year in which the rule was applicable; therefore, year one's costs were not discounted.

³⁴ Data taken from the Department's financial reporting database, at the Office of Labor-Management Standards, at <http://www.union-reports.dol.gov>. The search criteria were for national/international unions with total receipts greater than \$200,000 per year for the latest reported data.

³⁵ The Auto Workers have neither the highest nor the lowest per member receipt totals, based on our search criteria of the Department's database. The Air Line Pilots Association (AFL-CIO), for example, reported total receipts as of December 2001 of \$274.0 million and 54,513 members, yielding average per member receipts of \$5,026. By contrast, the Catholic School Teachers Association (an independent union) reported total receipts of \$307,149 as of August 2001 and 4,762 members, giving it average per member receipts of just \$65. Even in the case of Catholic school-teachers, our compliance cost estimate amounts to roughly 14 percent of their reported 2001 receipts. These compliance cost estimates, moreover, reflect lifetime costs of the rule and thus represent costs that would not be borne in any 1 year, but rather represent costs that would be spread out over several years.

A. First Year Compliance Burden Estimates

1. Install New Software

We allocated one-half working day (i.e., four hours) for software installation. Though the software installation itself should be fairly rapid and uncomplicated, additional time is allotted to allow for unanticipated bugs, incompatibilities, or to installation of additional software utilities and/or hardware as may be required to make a fully functional system.

2. Design/Adjust Report Forms and Format Structures to Comport with Regulatory Requirements

Electronic data processing systems simply store and facilitate the manipulation of basic accounting data, and though such systems greatly ease reporting in comparison to manual systems, one cannot necessarily conclude from this that little or no incremental effort is involved to comport with new or modified regulatory reporting requirements. That is, new or significantly modified reports are likely to be necessary in order to reflect the changed regulatory requirements.

We estimate that because of the detail involved in the seven new schedules on the LM-2, for example, each additional report will require at least one working day to design new output reports that follow the regulatory forms' requirements. This new burden is in addition to the 15.25 hours the Department estimates that it already takes to complete the forms, as they exist currently. In addition, although the new LM-2 also saw a net reduction in the number of questions asked by the Department, those reductions nevertheless represent changes to existing procedures that will have to be incorporated into new reporting practices. Therefore, we retain the Department's original estimate of 15.25 hours (rounded up to an even 16 hours, or two working days) and add to it the allowances described above for the new supporting schedules, resulting in an estimated total of 72 hours to design and reformat output reports.

3. Modify Existing Accounting Systems and Interfaces

Beyond reconfiguring and adding new accounting output reports, adjustments will also likely be required to the accounting systems themselves. Such adjustments may include addition of or modification to audit trails (to track why data were changed or accessed and when), time to adjust accounting procedures to reflect new regulatory thresholds (such as the changed minimum levels for disbursement tracking, investments, and so on), and time to implement data exporting features into the Department-provided software (e.g., e.LORS) or into similar reporting systems from the existing accounting programs. Additional time should also be allowed to accommodate the adjustment of any documentation retention policies and to communicate these policies to appropriate union personnel. We assumed these tasks could be completed, on average, in four working days, or 32 hours.

4. Incorporate Electronic Signatures

We assumed that two working days at a minimum would be required to incorporate electronic signatures into the reporting documents filed with the Department. This time includes not only incorporation of the signatures themselves, but also time to test and verify the security features of this application. As with any new technology, time estimates are only rough approximations. Substantially more time may be required to implement this new and unusual feature successfully and to ensure its overall integrity as part of the reporting system.

5. Validate and Reconcile Reported Output; Systems Testing

Reports, supporting schedules, and other output will have to be compared to known-good data sources in order to validate that the reports are producing reliable and accurate output. Inevitable discrepancies will have to be reconciled and corrective procedures implemented. In addition, the overall system will need to be tested to ensure smooth integration and functioning of all subcomponents. We allotted three working days to complete the validation processes for the new reports. Although this procedure is classified as a reporting function, it can also result in increased recordkeeping costs if records have to be revised as a result of errors uncovered during a reconciliation process.

6. Employee Training

We assumed that, on average, four accounting and/or regulatory compliance staff members would require training for two full working days (i.e., at 8 hours per day per person). Large unions are likely to incur proportionately more training costs in order to ensure that enough personnel are proficient in the new reporting require-

ments. Conversely, smaller unions are likely to see proportionately smaller training requirements.

B. Second Year Reporting

We made a simplifying assumption that, on the average, LM-2 report filers would be able to ascend 80 percent of the learning curve toward their final and best efficiency, with best efficiency being achieved in year three. In other words, although filers are expected to be much more efficient in year two than in year one, they will not reach peak efficiency until year three. Subsequent years beyond year three are assumed to see reporting burdens similar to those occurring in year three.

C. Third Year Reporting

By year three, we expect that unions filing form LM-2 will have become proficient at doing so and will require approximately 24 staff hours to complete the reporting required by the revised form. This figure represents an augmentation to the time estimated to complete existing forms. The Department estimates that it currently takes 15.25 hours to complete the LM-2 including its 15 supporting schedules. By adding 7 new and schedules, the Department has increased the simple volume of schedules by nearly 50 percent. In a few cases, moreover, the new schedules have the potential to be quite lengthy (e.g., the accounts receivable aging schedule, as well as the investments, receipts, and disbursements detail schedules). While it is true that the Department has shortened some of the existing up-front questions and data classification requirements, the largest incremental increase in reporting and record keeping seems likely to occur as a result of these new schedules.

We have, therefore, conservatively added 1 hour per new schedule to the existing estimate of 15.25 hours giving a total slightly less than 23 hours, on average, to complete LM-2 (once the institutional learning curve has been ascended). We then rounded our estimate up to the nearest whole working day, or 24 hours, consistent with our view that precision is not as important as general orders of magnitude.

D. LM-2 On-going Recordkeeping Estimates

We estimated that incremental changes to record keeping requirements would total approximately one additional working day on average. These estimates reflect our belief that on-going recordkeeping functions with respect to the new requirements are likely to exist beyond the confines of the union's accounting department—e.g., for anyone disbursing or receiving funds for example, who now must keep more-accurate records regarding where such funds were disbursed to or from whom such funds were received. These additional burdens, though probably small for any given accounting event, and likely to be dispersed across many people throughout a labor organization, nevertheless seem equally likely to sum to non-trivial amounts in the aggregate. This on-going recordkeeping burden is expected to persist at one working day, moreover, for years two, three, and beyond.

II. FORM LM-3 BURDEN ESTIMATES

The changes to the LM-3 form are minor. The requirements as to who must file a Form LM-3 have been changed, as has the requirement for increased disclosure if an LM-3 filer had an interest in a trust to which the filer contributed more than \$10,000 in a given year. Since these changes are minor, we assumed that initial reporting burdens (software changes, report adjustments, training, and so on) would amount to one additional working day per union filing the LM-3. As the LM-3 union became more proficient in year two, this burden would be expected to drop to 2 hours, and then to one-half hour by year three and beyond.

On-going record keeping requirements may be expected to total one hour in the first year and at most an additional half an hour in succeeding years.

III. FORM LM-4 BURDEN ESTIMATES

The changes to form LM-4 are as minor as for LM-3. Therefore, we assumed that initial reporting burdens (software changes, report adjustments, training, and so on) would amount to at most one additional working day per union filing the LM-4. Moreover, as the union became more proficient in year two, this burden would be expected to drop to 2 hours, and then to one-half hour by year three and beyond.

On-going record keeping requirements may be expected to total one hour in the first year and at most an additional half an hour in succeeding years.

IV. FORM T-1 BURDEN ESTIMATES

In estimating the burden for filers of the T-1 form, we used the same estimates of reporting and record keeping burdens used for the revised LM-2 form. The jus-

tification for this approach is suggested by the Department itself, when it states, “The new T–1 is structured similarly to the LM–2.”³⁶

V. SUMMARY TABLES

The following tables summarize the cost estimates based on the preceding sources and methods. Table A.1 summarizes the estimated hourly compliance burden and resulting cost estimates, while Table A.2 summarizes the capitalized estimates of the data in Table A.1.

TABLE A.1.—SUMMARY OF COMPLIANCE BURDEN AND COST ESTIMATES

Form	First year		Second year		Third year and beyond	
	Hours	Cost	Hours	Cost	Hours	Cost
LM–2	1,305,040	\$36,280.1	413,240	\$11,543.7	189,824	\$5,277.1
LM–3	116,266	3,232.2	32,389	900.4	13,081	363.7
LM–4	72,972	2,028.6	20,270	563.5	8,108	225.4
T–1	781,220	21,717.9	248,570	6,910.2	113,632	3,159.0
Total	2,275,498	63,258.8	716,469	19,917.8	324,645	9,025.1
Cost to Federal Government		7,187.0		7,187.0		7,187.0

TABLE A.2.—SUMMARY OF CAPITALIZED COST ESTIMATES

	First year	Second year	Third year and beyond	Discounted totals
Unions	\$41,540.9	\$12,156.6	\$73,196.2	\$126,893.7
Labor Trusts	21,717.9	6,456.2	39,416.7	67,592.8
Federal Government	7,187.0	6,716.8	89,677.2	103,581.0
Total Capitalized Costs	70,445.8	25,331.6	202,290.0	298,067.5

³⁶ Proposed Rule, p. 79295.

APPENDIX II.—RSP CHECKLIST—LABOR ORGANIZATION ANNUAL FINANCIAL DISCLOSURE REPORTS; PROPOSED RULE

	Element	Agency approach	RSP comments and grades
1.	Has the agency identified a significant market failure?	Although not clearly articulated, there is an implicit information asymmetry argument made throughout the proposed rule. Grade: N/A	There can be no market failure if the market is not allowed to function. The unionized labor market in the United States has been thoroughly impeded by previous federal legislation and regulations. These previous impediments opened the door to the abuses that the present rule attempts to correct. Thus the present rule is in fact an attempt to remedy a government not a market failure.
2.	Has the agency identified an appropriate federal role?	The Department cites the 1959 Landrum Griffin Act as the basis for its action. Grade: A	Given the way unions have been organized since at least the New Deal, the federal role cited by the Department seems correct.
3.	Has the agency examined alternative approaches?	The Department explores some alternatives with the context of the 1959 Act. Grade: B	Within the confines of the legislation and within the proposed rule itself, the Department has identified some alternative approaches to, and thresholds within, the present rule. The Department could have been more thorough however in recognizing that deterrence of financial mismanagement is not simply a matter of better reporting, but is instead also a function of periodic audits and investigations. Regular validation of reported data, in other words, should be made part of the rule.
4.	Does the agency attempt to maximize net benefits?	The Department does not attempt to value the benefits attributed to the rule. It does however assign a dollar value to compliance costs. Grade: C	Although we do not place a dollar value on the benefits either, we do attempt to put the costs of compliance into a variety of different contexts so that some evaluation can be attempted.
5.	Does the proposal have a strong scientific or technical basis?	The rule has the potential for some scientific basis through the application of Generally Accepted Accounting Principles (GAAP). Grade: C	It is possible that the Department's job could be greatly simplified by drawing upon disclosure procedures already established under GAAP. Adjusting GAAP to the peculiarities on union finance might then constitute the Department's marginal contribution to enhancing the disclosure process.
6.	Are distributional effects clearly understood?	The Department seems to ignore distributional consequences among unions themselves. Grade: D	By establishing single disclosure thresholds, the Department ignores potentially important differences among unions based on size. Thus, disbursements of less than \$5,000, for example, may be material for small unions, but are not material for larger unions until a much higher dollar figure is disbursed. A uniform disclosure threshold for all unions glosses over these differences.
7.	Are individual choices and property impacts understood?	The Department recognizes that the union members themselves are the owners (principals) and therefore have a right to know how the agents are performing on the owners' behalf. Grade: A	By recognizing that members who own the unions, and the public who confers the special privileges and immunities on them have a right to know the financial status of these organizations, the current rule is step in the direction of reasserting proper control over these organizations.

Dr. COCHRAN. Thank you, Mr. Chairman.

My findings then, as well as my remarks here today, support the idea that the new rules should help union members: one, better understand their union's financial position; two, make better decisions about the governance of their unions; and three, should help union members by making it more difficult to hide fraud and financial mismanagement.

The estimates provided in my original analysis of the rule placed its long-run or lifetime costs at roughly \$11 per union member on the average. My estimate of \$11 falls between estimates prepared by the Department of roughly \$6 per member and AFL-CIO cost estimates that range between \$14 and \$55 per union member based on newspaper accounts of the AFL-CIO cost estimates available at the time.

The Department's proposed regulations are an attempt to remedy a variant of the principal-agent problem; that is, the new rules try to correct an information asymmetry that exists between principals, union members, and their agents, union officials. Under the 1959 disclosure standards established with the Landrum-Griffin Act, it can be difficult for union principals to know the precise applications to which their funds have been put by their agents because of the summary nature of current union financial disclosure reports. The revised rules increase the volume and substance of disclosure and, by implication, raise the cost of committing fraud or hiding financial mismanagement. Basic economics tells us, therefore, that if we raise the cost of any activity, we are likely to see less of it; and clearly, reducing fraud works to the benefits of union member principals.

Of course, better financial disclosure is an important element of improving the financial transparency and accountability of unions to their members, but it is not all. I would, therefore, concur with Mr. Hiatt and suggest, for example, that regular audits by independent accounting professionals, periodic investigations by appropriate Labor Department personnel, as well as examinations of financial data by independent parties, such as union members themselves, journalists, Members of Congress, and ordinary citizens, are additional important tools that complement and complete any enhanced disclosure process. With respect to this last point, Mr. Chairman, I would like to commend you and the members of this subcommittee for your willingness to examine the issue of union financial disclosure more carefully.

Thank you.

[The statement follows:]

PREPARED STATEMENT OF DR. JAY COCHRAN

Good afternoon Mr. Chairman, Senator Harkin, members of the subcommittee, ladies and gentlemen. Thank you for the opportunity to comment today on the Labor Department's proposed rule regarding Labor Organization Annual Financial Reports.

I am Jay Cochran, a Research Fellow in Regulatory Studies at the Mercatus Center at George Mason University, and an adjunct professor of economics at GMU. Our mission at the Regulatory Studies Program is to advance knowledge of the impact of regulations on society by conducting careful and independent analyses using contemporary economic scholarship to assess rulemaking proposals from the perspective of the public interest. Thus, the work we do does not represent the views of any particular affected party or special interest group, but rather is designed to

evaluate the effects of government policies on overall consumer welfare. I would like to emphasize that the views I express today are my own and do not represent an official position of George Mason University.

In February of this year, I authored a Public Interest Comment on the Labor Department's proposed union financial reports rule. Mr. Chairman, I respectfully request that those formal comments on the rule be incorporated into the hearing record as part of my remarks here today.

My findings then, as well as my remarks here today, support the idea that the new rules should help union members:

1. Better understand their union's financial position;
2. Make better decisions about the governance of their unions; and,
3. By making it more difficult to hide fraud or financial mismanagement.

The estimates provided in my original analysis of the rule placed its long-run (or lifetime) costs at roughly \$11 per union member, on average. My estimate of \$11 falls between estimates prepared by the Department of roughly \$6 per union member, and AFL-CIO cost estimates that ranged from \$14 to \$55 per union member based on newspaper accounts of AFL-CIO cost estimates available at the time.¹

The Department's proposed regulations are an attempt to remedy a variant of the principal-agent problem. That is, the new rules try to correct an information asymmetry between the principals (union members) and their agents (union officials). Under the 1959 disclosure standards established with the Landrum-Griffin Act, it can be difficult for union principals to know the precise applications to which their funds have been put by their agents, because of the summary nature of current union financial disclosure reports. The revised rules increase the volume and substance of disclosure, and, by implication, raise the cost of committing fraud or of hiding financial mismanagement. Basic economics tells us that if we raise the cost of an activity, we are likely to see less of it; and clearly, reducing fraud works to the benefit of union member principals.

Of course, better financial disclosure is an important element of improving the financial transparency and accountability of unions to their members, but it is not all. I would suggest, for example, that regular audits by independent accounting professionals, periodic investigations by appropriate Labor Department personnel, as well as examinations of financial data by independent parties—such as union members themselves, journalists, members of Congress, and ordinary citizens—are additional, important tools that complement and complete any enhanced disclosure process. With respect to this last point, Mr. Chairman, I would like to commend you and the members of this subcommittee for your willingness to examine the issue of union financial disclosure more carefully.

Thank you.

STATEMENT OF LYNN TURNER, DIRECTOR, CENTER FOR QUALITY FINANCIAL REPORTING, COLORADO STATE UNIVERSITY

Senator SPECTER. Thank you very much, Mr. Cochran. Our final witness on this panel is Mr. Lynn Turner, Director of the Center for Quality Financial Reporting at Colorado State University, bach-

¹In preparing the estimate comparisons for the February 2003 Comment, at the time, I was unable to determine whether the AFL-CIO estimates presented in press accounts were annual or lifetime estimates of rule costs. I made the assumption, given the ranges of my estimates as well as those of the Department, that the AFL-CIO estimates were lifetime or long-run cost estimates. I have learned since filing our comments that the AFL-CIO's estimates were instead annually recurring estimates of cost. Using the AFL-CIO estimate, annual per member costs of the new rules are expected to be roughly \$56—equivalent to roughly two hours of the fully loaded labor cost of union labor in the United States. [Average hourly union labor rate from the Statistical Abstract of the U.S. (2001), Table 626, p. 406, and includes fringe benefits, SSI, UI, and workers compensation.]

The AFL-CIO's estimate of a billion dollars of annually recurring costs may be overstated for a number of reasons. First, we cannot verify the estimates since we do not know the method with which they were derived nor the data sources and assumptions upon which their estimates rely. Second, to generate first year costs of a billion dollars using the Mercatus method and assumptions requires that the applicable hourly wage rates double, while the number of labor hours required to bring union financial systems into compliance increase by an order of magnitude (or tenfold). While cost and burden estimates can be subject to some degree of latitude, a tenfold swing seems implausible because it would imply that adaptation to the new rules requires half a year just to modify systems and another half year to test the changes and train personnel. The changes as described by the Department do not seem likely to entail adjustment periods as lengthy as these. Third, a pattern of annually recurring billion dollar costs seems untenable on its face inasmuch as it reflects no learning curve effects, and because it apparently fails to distinguish between up-front and annually recurring costs.

elor's degree from Colorado State and an M.A. in accounting from the University of Nebraska. Thank you for joining us, Mr. Turner, and we look forward to your testimony.

Mr. TURNER. Thank you, Chairman Specter, ranking member Harkin, and the other members of the committee. I appreciate the invitation to testify at this hearing. I think it is a timely hearing on this important issue.

Due to the late hour in the day, I am going to summarize my written remarks fairly quickly here for you and ask that the entire written statement be put in the record.

Senator SPECTER. Your full statement will be in the record.

Mr. TURNER. As the former Chief Accountant for the U.S. Securities and Exchange Commission, as well as being a former executive in a major business, a former employee and union member as well, I fully understand the need for transparency in the union force and I do think it is important. Just as transparency, though, was important for us in the U.S. capital markets and for investors who use that information, it is equally important for union members and their regulator.

But it is important to remember that it has been demonstrated time and time again that proper governance, internal controls, and transparency are a prerequisite to a reduction of fraud, along with aggressive law enforcement and prosecution of those who have failed to maintain their fiduciary responsibilities. Disclosure of mountains of detailed financial data without independent verification or validation of that data absolutely does not ensure the mitigation of fraud or the transparency of the information.

Unfortunately, I believe the new rules proposed by ESA will fall short of their stated goal, while adding significant costs to a system that will have to be borne by the members and the dues that they pay to reimburse those costs.

The proposed approach is also significantly different from that adopted by the Senate by a 99 to 0 vote last year and by the House by a 432 to 3 vote, as well as signed into legislation by the President 1 week ago this year, that being the Sarbanes-Oxley Act.

The proposed rules are also dramatically different from those established by the U.S. General Accounting Office for ensuring proper reporting of receipts and disbursements by the Federal Government.

The level of detail reporting is significantly greater than businesses have to report today, certainly for those public companies that report with us at the Securities and Exchange Commission. For example, ESA has asked that accounts receivable and payables of \$1,000 or more be listed. It also requires investments and securities with a book value of \$1,000 or more be listed. There is no such reporting requirement for public companies. And as a CFO and VP of a major international semiconductor company, I never had to report in such small detail this type of information. I am concerned it will set a dangerous precedent in the future for requiring other entities, such as business, to have to report such minutiae.

In lieu of this, I would encourage ESA to adopt an approach similar to what Congress and the President did last year. Such an approach would, one, require an annual audit of the financial statements being supplied to the agency, which in this case is ESA. Dis-

closure would be required of material information, a standard set by the U.S. Supreme Court and the SEC and used by tens of thousands of private and public companies throughout the country.

Two, requiring the auditor to report on compliance with laws and regulations consistent with today's requirements of audits done in accordance with the GAO standards, consistent as well with those requirements requiring the auditor to issue a report on internal control. Smaller organizations could comply by including in their financial report to ESA a report by the responsible fiduciaries on the effectiveness of their organizations' controls so we get the right benefit and cost.

Three, a requirement that the auditor separately report on whether receipts and disbursements have been properly classified in accordance with generally accepted accounting principles, as we use them in the private sector.

Finally, fourth, proper accountability and oversight of the financial reporting process. This should be accompanied by requiring executives or fiduciaries filing financial reports to certify their accuracy and to the effectiveness of the controls necessary to ensure the safeguarding of assets and proper financial reporting and to require the establishment of an audit or advisory committee that would be responsible and accountable to the members of the respective labor organization.

Thank you and I would be happy to respond to any questions the members of the subcommittee may have.

[The statement follows:]

PREPARED STATEMENT OF LYNN TURNER

Chairman Specter, and Ranking Member Harkin: Thank you for the invitation to testify at this timely hearing on the issue of Union Financial Reporting and Disclosure.

As I believe you are aware, I served as the Chief Accountant of the SEC from July of 1998 through August of 2001. I also served on the staff of the SEC from June of 1989 through July of 1991. Currently I am a professor of accounting and Director of The Center For Quality Financial Reporting at Colorado State University. I also serve as Director of Research to Glass Lewis who provides independent research on public companies proxies and financial reports and as a senior adviser to Kroll, a financial services firm.

From June of 1996 to June of 1998, I was Vice President and Chief Financial Officer (CFO) of Symbios, Inc., an international manufacturer of semiconductors and storage solution products. Prior to joining Symbios, I served as a partner at one of the then "Big Six" international accounting firms, Coopers & Lybrand (C&L).

Financial transparency is important today. When financial transparency fails to meet the needs of the users of financial information, it can result in significant costs as the investing public has experienced during recent years.

As a former partner and leader of a business unit in one of the largest international accounting firms, as a former vice president and chief financial officer of a large international semiconductor manufacturer domiciled in the United States, and as a former regulator very familiar with financial reporting and disclosures (Chief Accountant of the Securities and Exchange Commission) I have significant experience with transparency in financial reporting, with employees and the work force environment, with business and with the public. As a former employee as well as a former union member, I fully understand the need for transparency for the labor force.

GENERAL COMMENTS

It is appropriate for The Department of Labor's (DOL) Employment Standards Administration (ESA) to improve transparency and to utilize newer technologies available today. It is also important that the current system be periodically revised to ensure its efficiency and transparency.

However, it is just as important to remember that it has been demonstrated time and time again that proper governance, internal controls and transparency are a prerequisite to a reduction of fraud, along with aggressive law enforcement and prosecution of those who have failed in their fiduciary responsibilities. Submission of data without independent verification or validation of that data does not ensure the mitigation of fraud or the transparency of the information. Rather, independent examinations and audits of the information by the private sector have proven to be a more cost beneficial approach to achieving the objectives of ESA.

Unfortunately the new rules proposed by ESA fall short of their stated goal. Instead, they raise a number of serious concerns including:

1. The approach taken in the proposed rules will not result in achieving the goal of reducing the level of fraud as discussed in the release. The proposed approach is dramatically different from that Congress and President chose to use in addressing fraudulent financial reporting by business, as set forth in the Sarbanes-Oxley Act of 2002. This legislation relies to a great extent on proper governance and the private sector as opposed to a government mandated system of reporting. The proposed rules are also dramatically different from the system established by the U.S. General Accounting Office (GAO) for ensuring proper reporting of receipts and disbursements of federal funds. Accordingly, ESA needs to revise its approach or it will entirely miss the target when it comes to a reduction in the level of fraud, while imposing significant costs.

2. The level of detail reporting is significantly greater than businesses have to report. For example, ESA has proposed that Unions be required to list accounts receivable and payables of \$1,000 or more. It also requires investments and securities to be reported if they have a book value of \$1,000 or more. There is no such reporting requirement of such small amounts by public companies and certainly I did not have to report such small details as the CFO of a large international semiconductor company. Adoption of this rule proposal would set a dangerous precedent for requiring other entities, such as business, to have to report such insignificant details. If businesses and the pension funds of their employees were compelled to report their receipts and disbursements in the level of detail to the various government agencies (DOL, Internal Revenue Service, and SEC) set forth in this proposal, it could harm the competitiveness of business and cause them to incur significant costs, without a corresponding level of benefit.

3. The Mercatus Center Regulatory Studies Program has commented on the costs expected to be incurred by the unions and government were the proposed rule to be implemented. I believe they have raised legitimate questions regarding the cost analysis. In addition, the proposal is deficient in that it fails to quantify in any meaningful way the benefits expected. Even with today's sophisticated financial systems, it takes time to program systems to provide disaggregated information regarding receipts or disbursements. In addition, many smaller organizations, such as those with under \$5 million a year in receipts may not have available to them the financial systems or resources that will readily provide the data requested. As a result, additional resources may have to be devoted to gathering this data.

IMPROVING TRANSPARENCY FOR LABOR ORGANIZATIONS

The proposed rule relies on disaggregated reporting of financial information to improve transparency to members of labor organizations. The proposal cites a particular case before stating: "This case demonstrates that detailed reporting can be an effective deterrent, and that more detail throughout the form LM-2 would further discourage malfeasance." Unfortunately, this is an improper conclusion. In fact as has been demonstrated on more than one occasion with the business community in recent years, those who have desired to commit fraud will do so, regardless of the level of detail reporting required. In the case cited there were improperly classified costs. Such costs can and most likely would continue to be misclassified by someone desiring to commit fraud, regardless of the level of detail required by form LM-2.

Rather than a bureaucratic governmental approach to improving transparency, ESA should follow an approach consistent with that used by other governmental agencies including the GAO and the SEC. This private sector based approach is also consistent with that established by Congress in the Sarbanes-Oxley Act of 2002 (Sarbanes). Rather than a focus on overly burdensome and costly detail reporting, it decreases the likelihood of fraud and increases transparency by requiring the establishment of proper oversight and governance, accountability, the adequacy of necessary internal controls and timely reporting of a lack of compliance with applicable laws and regulations by independent auditors. By utilizing outside "gatekeepers" in such a manner, it increases the likelihood that internal controls will prevent the oc-

currence of fraud in the first instance, and when fraud is committed, it will be detected in a timely fashion and provides a basis for prompt enforcement action by the responsible legal authorities.

The approach used by the GAO¹ and SEC, which has been widely heralded around the globe, would in lieu of the ESA proposal, require:

1. An annual audit of the financial statements being supplied to the agency which in this case is ESA. This could be accomplished by requiring larger labor organizations to have an independent audit performed of the financial reports and an independent auditor review financial statements of smaller organizations.

2. Requiring the auditor to report on compliance with laws and regulations consistent with the requirements of the GAO.

3. Requiring the auditor to issue a report on internal controls, consistent with the requirements of the GAO and Sarbanes-Oxley. Smaller organizations could comply by including in their financial report to ESA a report by the responsible fiduciaries on the effectiveness of the organizations controls.

4. A requirement that the auditor separately report on whether the receipts and disbursements have been properly classified in accordance with generally accepted accounting principles (GAAP).

5. Proper accountability and oversight of the financial reporting process. This should be accomplished by requiring executives or fiduciaries filing financial reports to certify their accuracy and to the effectiveness of the controls necessary to ensure the safeguarding of assets and proper financial reporting and to require the establishment of audit or advisory committees that would be responsible and accountable to the members of the respective labor organization.

OVERLY BURDENSOME DETAIL REPORTING SETS DANGEROUS PRECEDENT

The rule proposal sets forth a requirement for reporting of extremely detailed financial information for such financial statement line items as accounts receivable (\$1,000), investments (\$1,000), accounts payable (\$1,000), major receipts (\$5,000) and major disbursements (\$5,000). I can think of no other government regulation that I have ever dealt with or been subject to that requires such detail reporting by business entities. A government agency requiring reporting of detailed information that may clearly be immaterial, therefore sets a dangerous precedent that may be used as a basis by other agencies to also require such intrusive reporting of unnecessary detail.

Other U.S. Government agencies such as the GAO and SEC have instead set financial reporting requirements that require "material" information be disclosed to those using the financial information.² ESA's proposing release states that today's workforce is better educated, more empowered and more familiar with financial data than before. Given that statement, ESA should focus on ensuring members of labor organizations receive "material" information rather than bombard them with detailed reporting they will not utilize and which will result in government imposed costs that are ultimately born by the members.

Some have argued that materiality is a "vague and complicated" standard for determining disclosures to be made to interested parties. However, the U.S. Supreme Court has established a standard for applying materiality in assessing necessary disclosures to the investing public. Both public and private companies have for decades applied this standard when preparing their financial reports and have become accustomed to its application. It has proven to be an enhanced approach to one that is "rule-based" on a bright line test that is mandated for every reporting entity.

Rather than the proposed detail reporting approach, ESA should rely on private sector standard setters, just as the DOL has for many years for financial reporting of private sector pensions. ESA should look to the accounting standard setters such as the Financial Accounting Standards Board (FASB), and the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants for the establishment of the necessary financial reporting and auditing standards. The government including the DOL, has for many years have relied upon the private sector to establish the appropriate standards that will provide the necessary level of transparency in financial reports and the appropriate auditing standards. ESA should not engage in government intervention in financial reporting, a role that is better left to the private sector. Rather ESA should work with the private sector standard set-

¹For further information on the United States General Accounting Office approach, see Government Auditing Standards, June 2003 Revision.

²Staff Accounting Bulletin No. 99, Materiality, Securities and Exchange Commission. 1999. Available at website: <http://www.sec.gov/interps/account/sab99.htm>. This guidance which has also been upheld in the U.S. Federal courts establishes what information is to be considered material information.

ters to improve the existing system if ESA believes there are areas in need of improvement.

A prime example of why ESA should rely on the private sector rests in the proposal to require additional detail reporting by unconsolidated affiliates of labor organizations. However, as is often the case in private business enterprises, the reporting entity may not have the prerequisite authority to demand the information that ESA is specifying be disclosed. In fact, the reporting entity may not have the legal authority to require that information if it is not in control of the affiliate. When it is in control of the affiliate, GAAP would require the accounts of the affiliate be consolidated with those of the reporting entity. GAAP also requires disclosure of material transactions with related parties such as affiliates.³

The FASB and business enterprises have worked for some period of time trying to develop a workable approach to disclosure of information with respect to affiliated entities that are controlled by the reporting entity as well as those who are subject to significant influence by the reporting entity, such as the labor organization.⁴ This has been a very difficult undertaking for the FASB, its predecessors and businesses. Some of the same difficulties will no doubt be encountered by ESA and the reporting labor unions. A hastily developed rule by ESA may in fact turn out to be one that cannot be complied with. Accordingly, ESA should work closely with the private sector to develop a workable approach and avoid a costly mistake.

SIGNIFICANT COSTS TO BE INCURRED

The proposing release states that "In 2000, 5,426 unions, including 141 national and international unions reported \$200,000 or more in total annual receipts . . ." Later on in its Initial Regulatory Flexibility Analysis ESA also questions the \$6 million dollar threshold set by the Small Business Administration.

I strongly disagree with ESA's statement that the SBA standard is unreasonably high. These standards are established in consideration of smaller organizations that may be unfairly burdened with government mandates and imposed costs, in light of their very limited resources. Regardless of whether it is a labor organization or a business, an entity with annual receipts of between \$200,000 and \$6 million is clearly a small entity that will have limited resources. The SBA's determination in this respect was not unreasonable. The ESA conclusion based simply on the number of unions with over \$1 million in receipts is ill-reasoned. Using that type of reasoning for businesses would result the bar being raised significantly on what constitutes a small business as the vast majority of businesses in the American economy fall within the definition of a small business by the SBA or other government agencies such as the SEC.

As a former chief financial officer, I have also had to work with and use disaggregated information. I believe the agency has significantly underestimated the amount of hours, perhaps by a multiple rather than just a percentage that it will take to gain an understanding of the new rules, reprogram software, determine and report the requested disaggregated information properly. I find the type of analysis prepared by the Mercutus Center to be worthy of your consideration. There will also be a significant hidden cost if this reporting becomes a precedent used by the DOL for other pensions or by other government agencies for business enterprises. The proposing release also fails to quantify the benefits of the proposal, why they exceed the expected costs. The proposal also fails to provide evidence that the detailed reporting approach will yield the benefits it seeks to achieve for members of labor organizations when in fact there is a lack of such evidence in the private sector.

CONCLUSION

ESA should revise its proposal to adopt the approach recently enacted by Congress and the current administration in dealing with misleading financial reporting in the private sector. ESA's approach to reducing fraud by requiring disclosure of information in greater detail in no way ensures the integrity of the data through independent verification. As a result, fraud may continue to go undetected and union members mislead by disclosures that have not been independently verified. Instead, ESA should adopt a proven approach based on establishing proper oversight and governance, accountability, the adequacy of necessary internal controls and timely reporting of a lack of compliance with applicable laws and regulations by independent auditors. It is an approach that relies on the private sector standard setters and gatekeepers as opposed to a bureaucratically imposed governmental sys-

³ FASB Statement No. 57, Related Party Disclosures. 1982.

⁴ See also Accounting Principles Board Opinion No. 18, Accounting for Equity Method Investments in Common Stock. 1971.

tem that is unlikely to achieve its stated objectives. It is also a system that will likely have a lower cost while achieving the desired benefits.

Senator SPECTER. Well, thank you, Mr. Turner.

Mr. Cochran, what is your evaluation of the LM-2 requirements compared to Sarbanes-Oxley? Are they more complicated?

Dr. COCHRAN. I did not do a comparison between this rule and Sarbanes-Oxley, so I cannot answer that directly. But I do believe that to say that this rule imposes a burden that is heavier on unions than the disclosure standards incumbent upon publicly traded corporations I do not think is true, or at least I do not think it will hold up to detailed study.

However, having said that—

Senator SPECTER. Are the requirements of Sarbanes-Oxley not a fair statement today at least as to the level of inquiry which the Congress has asked for?

Dr. COCHRAN. I am not sure I understand the question, Senator.

Senator SPECTER. Well, Sarbanes-Oxley was enacted after there were very substantial failures of integrity in corporate disclosures and was subjected to a lot of analysis. There has been some contention that it goes too far, in fact, a fair amount of contention. So one baseline for consideration would be whether LM-2 goes beyond Sarbanes-Oxley because Sarbanes-Oxley had a lot of consideration and analysis by the Congress.

Dr. COCHRAN. That is right. And there is one attribute with respect to the LM-2 where it could possibly exceed what is placed on corporations, whether it is through Sarbanes-Oxley or traditional SEC filings or whichever, and that is the detailed disclosure standards with respect to disbursements, accounts payable and receivable, and so on. And we indicated in our comments filed last winter that we would support or we would suggest that a materiality standard might be the more appropriate response rather than specifying a dollar threshold so that you do not get reams and reams of paper of, for example, accounts receivable printouts.

Senator SPECTER. Define what you mean by a materiality standard.

Dr. COCHRAN. Well, a materiality standard as it applies in accounting. In other words, would a reasonable person need to know this information in order to have an accurate picture of the financial position of the union.

Senator SPECTER. Ms. Lipnic, what do you think about a materiality standard?

Ms. LIPNIC. Senator, that is something that we have had some comments on and we are taking a look at that. I think in many ways the threshold requirements that we are putting into the LM-2 reporting serve some of that purpose as a materiality standard, and we specifically sought comments—

Senator SPECTER. Serve some of the purpose, but does it go beyond materiality?

Ms. LIPNIC. Not being an expert in accounting, I do not necessarily feel qualified to give a—

Senator SPECTER. You may not be an expert. You know more than the Senators do. That may be an unrealistic minimal standard to compare to, and it may be that the inquiry is premature because you have not promulgated the regulation. We do not know

whether it is \$2,000 or \$5,000. And if you are considering materiality, it may well be that your final product will be somewhat, if not substantially, different. But when you talk about materiality, you are talking about an accepted accounting principle, something as the word "materiality" says, which is material, that is, relevant, germane to accomplish a purpose. I would suggest that that might be something worth looking at.

The estimates as to cost differ enormously. The Department of Labor says the first-year costs should be \$14.6 million and about \$3.3 million in second year. The AFL-CIO estimates that the total cost to unions will range from \$309 million to \$1.1 billion. It sounds to me like we are trying to settle a personal injury case, with all due respect.

Mr. Hiatt, how do you come to \$309 million to \$1.1 billion?

Mr. HIATT. That is a large range, Senator, but—

Senator SPECTER. I know it is a large range. How do you get there?

Mr. HIATT. We had an economist do a survey of all of our national and local unions, and we obviously were dealing, therefore, with a sample of unions that responded to the survey. It was the overwhelming percentage of national unions and a significant number of the local unions. Within that sample, the economist broke down the cost based on locals and national unions, and then we had another expert who used the Department's own filing system that breaks out local unions by nine levels of revenue. Within the sample, they came up with average costs, as well as median costs. Because of the difference in outliers under the two systems, you had more medians. As a result, we took the very lowest—

Senator SPECTER. Average as well as median cost?

Mr. HIATT. We did average as well as median.

Senator SPECTER. Did you get mean costs?

Mr. HIATT. And mean costs. As a result, we had the very lowest coming out at \$300 million and the very highest at \$1.1 billion.

But I think the most significant issue here is that the Department admits in Federal Register that its estimate is not based on data. It is based on a gut feeling or based on discussions that it may have had with some of its staff, but it acknowledges that it did not start out with any of the data that would allow it to perform a burden analysis and instead was relying on the unions in their comments to provide the data. We have done the best we can, and as big a range as it is, it is clear that this burden is multiples more than what the Department would like to think would be involved in this record keeping.

I think the materiality standard would certainly be one factor that would affect the cost here because as it now stands, no matter how detailed, no matter how trivial, no matter how minute the transaction is, if it ends up totaling in the aggregate more than this \$2,000 to \$5,000 threshold, the union will have to keep records as to all aspects of that transaction and it probably will not know during the year whether we end up with a \$2,000 or a \$5,000 limit. It probably will not matter because for most of these transactions, the union will not know at the beginning of the year whether it is going to hit the \$2,000 or the \$5,000, whatever the level would be, until the end of the year.

Senator SPECTER. Let the record show that I finished my question before the red light went on.

Senator Murray.

Senator MURRAY. Thank you very much, Mr. Chairman.

Ms. Lipnic, the Department's notice of proposed rulemaking makes it clear that the Department did not conduct any survey of the unions before it published its proposal. In fact, the notice of proposed rulemaking states—and I am going to quote this—"information regarding the burden imposed by making the proposed changes and the benefit to be gained is most likely to be obtained by proposing the changes for comment so that unions who file these reports, union members, and other groups that represent workers can express their views."

How do you justify your failure to conduct a survey of the unions that will have to shoulder the immense financial burden of this rule in light of the regulatory requirements that the Department is required to follow such as Executive Order 12866 and the Regulatory Flexibility Act?

Ms. LIPNIC. Senator, in doing our analysis in proposing this rule, we did follow all of the requirements from OMB under the executive order. We also did a regulatory flexibility analysis even though we were not required to do this because this was not an economically significant rule.

Senator MURRAY. It is not an economically significant rule for who?

Ms. LIPNIC. Within the context of how OMB determines whether rules have economic significance for the economy.

Senator MURRAY. Mr. Hiatt, will this have an economic impact?

Mr. HIATT. This would certainly have an economic impact and we do not believe the OMB has accepted the Department's conclusion that this is not an economically significant rule. There was a good deal of controversy around that. The Department was basing its conclusion in part on the belief that local unions are not small businesses, even though under the Small Business Administration's own definition of a small business, every single one of these covered entities would come under the small business threshold. The Department apparently did not accept that and that is what at least in part has led them to conclude this does not have to be treated as an economically significant rule.

Senator MURRAY. Ms. Lipnic.

Ms. LIPNIC. Although Mr. Hiatt is correct that we did not accept the \$6 million threshold, we did in fact do the regulatory flexibility analysis that is required by OMB for promulgating this rule, and in terms of the controversy associated with whether OMB determined it was an economically significant rule, in fact I think the record would reflect that OMB concluded with the Department's analysis that it would be considered what is called an "other significant rule," and that was what had long been on the Department's regulatory agenda.

Senator MURRAY. Regardless, there was no survey of unions done beforehand. Correct?

Ms. LIPNIC. That is correct.

Senator MURRAY. The Department's proposal states that no specific data exists regarding the extent to which unions have already

embraced the technology necessary to provide reports in electronic form, but the Department has proposed a technology-based rule that requires unions to file their LM forms electronically. Can you explain the Department's failure to conduct any study whatsoever on the technological capabilities of the unions that are now going to have to file these LM-2 forms?

Ms. LIPNIC. Actually, Senator, we did engage an outside contractor, a software firm, and part of the technical feasibility study that the software firm put together for the Department and that we made available through the public comment period included some analysis of software packages, accounting packages in particular, that are used by unions to file their forms.

Senator MURRAY. Well, but the fact is that the software does not exist today.

Ms. LIPNIC. That is correct. The software is under development.

Senator MURRAY. I have seen software under development for large projects for years before it ever works. Is the Department aware of that?

Ms. LIPNIC. We certainly are aware that software projects can take a long time. That is also why we engaged the contractor, we had the feasibility done, and—

Senator MURRAY. I have heard a lot of contractors say we are going to have this done by July 1 and it is July 1, 3 years later, and it costs 10 times as much. I just have to tell you, having worked with many government agencies that have gone down that road—how can the Department even have the vaguest idea whether unions can comply with this proposal if it does not have the software there now that is going to enable them to file these forms that are going to be required?

Ms. LIPNIC. Again, Senator, our study tells us that this is relatively simple software that will not create great problems for the unions or the Department in filing—

Senator MURRAY. You have a contractor who says I can do this.

Ms. LIPNIC. We have a feasibility study that says that, yes.

Senator MURRAY. Well, I would just remind all of us that anybody who has worked with large government agencies, whether it is a school district or a business that has required an IT department to come up with software, they always say they can get it done, but there is always cost overruns. It always takes longer and it does not always work. So I would hate to see a rule imposed on unions without knowing that they have the ability to have the software in front of them that works. Otherwise, this is going to be a real burden to a lot of people.

I know my red light is on. I do have some other questions, Mr. Chairman, and I assume we can submit them for the record and get responses back.

Senator SPECTER. Of course, Senator Murray, if you submit them for the record, I am sure they will be answered by the panel.

Senator Craig.

Senator CRAIG. Mr. Chairman, thank you very much.

I am pleased that you brought up Sarbanes-Oxley. That seems to be at least a threshold measurement today that we here in Congress believe is critical and important.

Those of us who sit at this dias are also subject to something else, campaign finance reform. And a lot of us run mom and pop organizations once every 6 years. We gear up. We spend hundreds of thousands of dollars, but we report every financial transaction that is conducted within a campaign. We do it for legitimacy. We also do it for the electorate to know where our money comes from and where it is spent.

While I agree with the Senator from the State of Washington that software is always a problem, there are 15 or 20 vendors out there in the public arena today that are hawking the software for campaign reporting. It is all geared to the FEC rules and regulations. Once input is made on a function by function basis, a button is pushed and electronic reporting occurs. Or I can walk down to the Secretary of the Senate's Office and hand it in in paper form. That is true for the U.S. Senate where campaigns are oftentimes more expensive. It is also true for the U.S. House where I think by definition you could still say in a few congressional districts mom and pop campaigns operate up to maybe \$500,000 or \$600,000 or \$800,000 or maybe \$1 million every 2 years. But that reporting is necessary and it is demanded by law. We are doing the same thing of corporate America today for the obvious reasons.

I must tell you that when I hear about furs and Tiffany silverware being purchased or I see tens of millions of dollars being labeled as vague and non-informative categories, like \$62 million simply being labeled for grants to and joint projects with State and local affiliates or \$45 million for other disbursements and these are union members' dues and money that is being spent, what I would want to have would be the same kind of functional disclosure that every political campaign, Federal political campaign, in this Nation is subject to. I think it is right and appropriate, honest, fair, and most importantly, it is transparent because it is the members of the unions' money. That is what it is.

What is more important about it is not necessarily the critical eye that the Department of Labor gives it, it is the critical eye that public disclosure gives it. FEC sometimes does not really ever get at what we report in a timely fashion, but the news media does, and every time a financial statement by a campaign is made, it is oftentimes printed up within 24 hours in the local media, and that is without doubt the finest disclosure available in the world today. I believe in it. It is honest and it is fair.

Now, in multi-million dollar union organizations, I would not expect the kind of full disclosure that political campaigns are subject to, but I do believe that if these rules have not been reformed in 44 years, they deserve a thorough reforming. And for anybody to suggest that it is going to be too expensive is to suggest that fraud and abuse is okay if it exists or that the inability to find it through disclosure is okay because the other side of it is just too expensive. Well, if it is too expensive, let us figure out a way to make it less expensive. But let us have full disclosure.

I applaud DOE—or in this case, DOL, Department of Labor—I have been involved with DOE too much all day today for going after it. At the same time, I would expect that they would work with the unions to develop something functional, viable, hopefully less expensive than what is at least being bandied around in the

broad perspective of it, but something that the public can effectively look at and say, oh, that is where our money is going, or in the case of the membership, that is where our money is going. That is how much it costs. And thresholds would be important.

Mr. HIATT, I hear it bandied around. What is a mom and pop union?

Mr. HIATT. Well, just to give you an example, Senator, 40 percent of all of the unions that would be covered by this rule have, according to the Department's own figures, annual revenue that is \$400,000 or less. What that means is that if, in fact, the average of what our survey showed, the average cost to a local of complying with just the record keeping and reporting—I am not talking about the cost of the underlying transactions. Just the record keeping and reporting at \$217,000 for a local union, not a national union, this would be more than half of the annual revenue of the local itself. I would call that relatively speaking a mom and pop local union. It is a union whose lead officer has a full-time job on the factory floor or in the work place who on a volunteer basis is serving as the president or secretary or treasurer of his or her local union who is not being paid for that, who does not have staff, who does not have professionals, who would have to go out and hire professionals for this kind of work. I would call that a mom and pop operation, and it is not a rare exception. It is very common within this universe of entities that would be regulated.

Senator CRAIG. What is the requirement of their disclosure today?

Mr. HIATT. Actually, in many ways, Senator, for any individual union member who wants access to all of the underlying documents and records, they have under Landrum-Griffin today, under the LMRDA, the right to go beyond the forms that are filed. And there is an elaborate record keeping and reporting system that already, of course, is in place where unions do have to file annually. All of these entities already are having to file. But to take the example that you raised of the category of other disbursements that do not fit into one of the functional categories on the form, any union member who has any questions or is at all suspicious has the right to seek access to the books, and the union—"for cause" is the language in the statute, but as a practical matter, I am not aware of one union who denies an individual member who comes in and asks to see the underlying books, under the Landrum-Griffin right to do so, that right. And he or she then can get access to the records showing each and every one of the disbursements or the other underlying financial documents.

Senator CRAIG. Do they have to request the examination or is it printed so they can see it publicly on an annual basis?

Mr. HIATT. If they wish to go beyond what is now made public on an annual basis, then they make a request to see more. The regular LM-2 forms are submitted. They are available. If you go into the Labor Department at any given time to ask for access to the LM-2's—and this is actually before—I think they have just now put them online, but if you go in in person and ask, you are given access to them.

Although interestingly, it is very rare that a person who is in the Labor Department's Office inspecting LM-2's is anyone other than

a management-labor lawyer seeking information off of those forms on how to use information about the union in the next organizing campaign or in the next bargaining campaign. For the most part, the entities that have been complaining about inadequate disclosure on the LM forms are these so-called union busting consultants who have been looking for more information about where the union has been organizing or what kind of legislative lobbying they have been doing.

Senator CRAIG. Nobody is in there looking or concerned about fraud or abuse.

Mr. HIATT. I am sure there are. There should be. I would hope there are. And we support that.

Senator CRAIG. I would agree with you that if the forms being proposed are going to cost half the income, if you will, or the general revenue of a local union on an annual basis, that is excessive. My guess is that could not happen. To report \$400,000 worth of income and general disbursement twice a year, quarterly, campaigns do it every month. Sometimes they do it every 2 weeks in the last month of a campaign by pushing a computer button. And software, once developed is very inexpensive. And I understand mom and pops very well, from businesses to unions. So I would concur with you. That would be excessive.

What I cannot and will not accept—and I applaud the Department for doing it—is taking 44-year-old ideas and making them 21st century transparent. No union member should feel intimidated by asking to go beyond what is open and readily available in the public eye because intimidation might be a factor if he or she suggests that they want to look deeper into the records of their own union.

Mr. HIATT. Senator, I do not disagree. I think the whole question is what is the nature of the specific requirement that is being imposed, and we are only arguing with what is the nature of this particular proposal, not whether there should be transparency.

We made a Freedom of Information Act request as part of this process, and we received a memo that then-Congressman Gingrich had sent to Senator Martin in 1992 when the Department briefly considered a very similar proposal, although not as onerous, urging Senator Martin, Labor Secretary Martin at the time, to speed up this type of reporting requirement because it would weaken our opponents and encourage our allies.

Senator CRAIG. Well, Newt is not around anymore.

I do not care what Newt Gingrich said.

Mr. HIATT. This is even worse. What they are now proposing is more onerous than what was done in 1992.

Senator CRAIG. What I most care about and will urge the Department to do is to move you toward economically feasible, fully transparent reporting for the sake of your membership.

Thank you.

Mr. HIATT. Thank you.

Senator SPECTER. I would pick up on what I understood Senator Craig to say, if I am correct about this, that it would be useful for the parties to try to see if there is some middle ground. Mr. Hiatt agrees with transparency and Mr. Cochran, who speaks in support of the Department of Labor position, injects the word “materiality.”

And there is not now an audit requirement. Senator Craig starts off with reference to Sarbanes-Oxley as a standard which the Congress has accepted. And I have heard a lot of comment.

I would be interested, Ms. Lipnic, in your view. Do you agree that the current LM-2 is more complicated than Sarbanes-Oxley?

Ms. LIPNIC. Actually, no, Senator. We specifically looked at revising the LM-2 form because we thought that would be a less burdensome requirement than attempting to impose the kind of reporting requirements under Sarbanes-Oxley.

Senator SPECTER. So you think LM-2 is easier than Sarbanes-Oxley?

Ms. LIPNIC. Yes, we do, and also it is a familiar reporting form that has been in place for 40 years and unions are certainly used to filing under this form.

Senator SPECTER. But there are a lot of changes. Dr. Cochran, you said you do not really know. What is your position on the LM-2 proposal compared to Sarbanes-Oxley?

Dr. COCHRAN. Well, again, I did not do a direct comparison between the rule and Sarbanes-Oxley, so I cannot answer that directly. But I think it is clear that the rule does increase the burden on unions. That is why we have costs. Right? Because we are increasing the burden, we are increasing the number of hours—

Senator SPECTER. The question that I am trying to focus on is whether it increases the burden beyond that which corporations now have.

Dr. COCHRAN. In an unduly burdensome fashion? I do not think so. In our comments we—

Senator SPECTER. Not unduly burdensome.

Dr. COCHRAN. No, I understand.

Senator SPECTER. Sarbanes-Oxley, because unduly burdensome is subjective. Sarbanes-Oxley is tangible.

Let me suggest to the parties here you have not come to a final rule. Have the parties, the AFL-CIO and the Department of Labor, sat down to try to find common ground?

Mr. HIATT. I will be interested to hear the Department's version in answer to that question.

Senator SPECTER. Do not everyone speak at once.

How about it? Have the parties sat down? How about it, Dr. Cochran?

Dr. COCHRAN. I have no idea whether the parties have sat down. I am an outsider.

Senator SPECTER. Apparently nobody else does either.

Mr. HIATT. We sat down with the Department about 9 months before they published the proposed regs when, as a result of testimony by the Deputy Secretary of Labor at a hearing, they acknowledged they were considering changing these regs. And we asked if we could sit down with them. The panel was surprised to hear there had not been any input. We sat down at the time—

Senator SPECTER. What panel was surprised?

Mr. HIATT. It was a House panel.

Senator SPECTER. House of Representatives?

Mr. HIATT. Yes, Senator.

Senator SPECTER. The Senate might be able to agree with the House on something.

Mr. HIATT. Well, it was on a different subject, but in the course of it, the Deputy Secretary acknowledged that this exercise was going on.

We then met and at the time the Department was not able to tell us what they were going to be proposing. They said it was still too early. We asked if they would agree to meet with us when they had a better idea but before the proposed regulation was published. At the time, they said yes, but then they withdrew that offer and we were never able to have a meeting from the point at which they had apparently decided what the proposed reg would include.

Senator SPECTER. Well, let me make a suggestion. The parties can do as they choose, and the Congress has its own options in the legislative context. But it could be an extension of the comment period. It could be a form of comment on discussions. We have been in the midst of the complexities of asbestos and this is not as complicated as the asbestos bill. All the parties have thought it would be useful to go to the Chief Judge Emeritus of the Third Circuit to take a look at it, and it might be that somebody could sit down with the parties here. I think there is a general recognition that more needs to be done. There is now not a requirement for an audit.

Would you agree that there ought to be an audit, Mr. Hiatt?

Mr. HIATT. We have indicated that we believe that some sort of an audit requirement would make sense.

Senator SPECTER. That is a yes?

Mr. HIATT. Yes, it is, subject to specific issues that probably would vary based on size of unions and so on.

Senator SPECTER. So it is subject to. Well, an audit will have to be defined. If it is a yes—

Mr. HIATT. Yes.

Senator SPECTER [continuing]. That is a little progress.

Mr. HIATT. Maybe Judge Becker could help us out with that.

Senator SPECTER. He is busy.

I think this hearing has been very useful. I have talked to Secretary Chao about it, and I know she wants to come to a reasonable resolution. It seemed to me that this hearing would be helpful to bring the parties together and talk about it. I personally believe that most of these issues are susceptible to agreement. We are all after a common goal. The parties are a lot better off sitting down together and figuring it out as opposed to having it come to the Congress because the Congress invariably knows a lot less than the parties do, even those of us who have sat through this hearing.

ADDITIONAL COMMITTEE QUESTIONS

There will be some additional questions which will be submitted for your response in the record.

[The following questions were not asked at the hearing, but were submitted to the Department for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR PATTY MURRAY

PROPOSED RULE FOR ELECTRONIC FILING OF LM-2 FORMS

Question. The Department's Notice of Proposed Rulemaking makes it clear that the Department did not conduct any "survey of unions" before publishing its pro-

posal. In fact, the NPRM states that, “[I]nformation regarding the burden imposed by making the ‘proposed changes’ and the benefit to be gained is most likely to be obtained by ‘proposing’ the changes for comments so that unions who file these reports, union members, and other groups that represent workers can express their views.”

How do you justify your failure to conduct a survey of the unions that will have to shoulder the immense financial burden of the rule in light of the regulatory requirements that the Department is required to follow, such as Executive Order 12866 and the Regulatory Flexibility Act?

Answer. The Department of Labor has engaged in a process that fully complies with all regulatory requirements, including Executive Order 12866 and the Regulatory Flexibility Act, and was designed to ensure that all stakeholders have meaningful input.

The Office of Labor-Management Standards (OLMS) had meetings with the AFL-CIO and representatives from more than 40 international unions in which OLMS described the Department’s general approach to the reform and encouraged the attendees of the meetings to submit ideas on a range of subjects. Other senior officials of the Department also met with union leaders to discuss their concerns before and during the rulemaking process.

In addition to the outreach discussed above, the Department extended the comment period for the proposed rule by 30 days and published a technology study conducted by an independent software developer to ensure that the public had an opportunity to comment on the rule and the burden associated with the proposal. As your quote from the NPRM indicates the Department correctly believed that the comment period would be the best source of input from our important stakeholders. The Department received over 35,000 comments, including a 218 page comment from the AFL-CIO that contained 3 studies. Other detailed comments were submitted by almost every international union. The Department is carefully reviewing and considering all of these comments.

Question. The Department’s proposal states that “no specific data exist regarding the extent to which unions have already embraced the technology necessary to provide reports in electronic format.” Yet the Department has proposed a technology-based rule, in that it requires unions to file their LM forms electronically.

Can you explain the Department’s failure to conduct any study whatsoever on the technological capabilities of the unions that will have to file the revised LM-2 forms?

How does this failure square with the Department’s responsibility under Executive Order 12866 to base its rules on the best scientific, technical, economic, or other evidence?

Answer. The Department of Labor has engaged in a process that fully complies with all regulatory requirements, including Executive Order 12866. The Department is confident of the technological aspects of the proposed rule for a number of reasons.

The development and implementation of an electronic filing system is not a new project for the federal government or the Department. In fact, OLMS completed an electronic filing system last year that performs many of the key functions that the proposed system would be required to perform, such as pre-populating certain data, importing certain schedules, entering information directly into the form, various levels of data validation, attaching digital signatures using Public Key Infrastructure (PKI) technology, and submission via the Internet. Other government agencies, including the Securities and Exchange Commission (SEC) and the Federal Election Commission (FEC) have successfully developed electronic filing systems that involve comparable system requirements. The success of OLMS’s effort is reflected in the fact that approximately 75 percent of Form LM-2 filers now use the OLMS provided software to prepare their annual financial reports.

The AFL-CIO also reported in their public comments that all national and international unions and over 87 percent of all local unions use computer accounting software. The NPRM explained that the OLMS electronic filing software would be designed to work with commercial-off-the-shelf accounting packages that are inexpensive and widely used. Most unions would continue to use the same accounting software they use today and at the end of the year they would transfer the appropriate financial data to the Department’s filing software provided at no cost to the unions. The Department also included a hardship exemption procedure in the NPRM that was modeled after the procedure used by the SEC for those few Form LM-2 filers that do not have the capacity to prepare and submit the form electronically and specifically asked for comments regarding whether this procedure is appropriate or another procedure might better address legitimate problems. The Department is carefully reviewing and considering all of the comments.

Question. One of the Department's central claims about the rule is that unions will not have a huge compliance burden because DOL will provide the software necessary to file the forms electronically. Yet the software does not exist yet and the Department refused to slow down the timetable so that it could develop the software and allow the unions to comment on the feasibility of using it.

How can the Department have even the vaguest idea of whether unions can comply with the proposal if it has not yet developed the software that will ostensibly enable unions to file the forms electronically?

How can you justify proceeding with the rulemaking in the absence of the software in light of your obligation under Executive Order 12866 to base the rule on the best available technical and scientific information?

Answer. In January 2002, the Office of Labor-Management Standards began distributing computer software to unions that enables them to complete the existing forms electronically. Approximately 75 percent of the unions currently filing Form LM-2 reports are using that software to prepare those reports.

In connection with the proposed rule, the Department contracted with a professional provider of information technology services, SRA International (SRA), to assess the technical feasibility of electronically collecting and reporting the information that would be required by the proposed changes. SRA concluded that the technology existed and was mature enough to support the Department's proposed reporting system. The study was helpful in preparing the Department's burden estimates in the NPRM. In particular, the study provided insights regarding the costs that would be incurred by unions to make adjustments to their recordkeeping systems and to transfer the data to the filing software at the end of the year. The SRA technical feasibility study was also made available for public comment during the rulemaking.

While the SRA study confirmed that the Department's proposal was feasible, in terms of current technology, it would not make sense to develop software based solely on a proposal because the Department is seriously considering thousands of comments, many of which suggest changes to the proposal. The software that will enable unions to file their reports electronically cannot be developed until there is a final decision whether the final rule will require electronic filing and what the report will contain. Software would then be made available to unions long before they would be required to file a report in compliance with such a final rule.

It is important to note that the purpose of the software is to reduce the reporting burden on unions and to reduce the cost of disseminating the information on the Internet to union members. The implementation of the reporting software would come in two phases. First, in conjunction with any final rule that requires electronic filing, the Department would provide a Data Specifications Document, that will give unions the information they will need to interface with the software and report their information to the Department electronically. Second, as noted above, the software enabling unions to file electronically would be provided to the unions well before they would have to use it to file their reports.

Finally, the Department specifically requested, and is currently considering, comments on whether the proposed effective date (allowing at least fifteen months following publication of a final rule before any union would have to file electronically) provided a sufficient time period for unions to comply with a final rule. The Department is also going to establish a help line to answer any questions and will make other compliance assistance available, including assistance with respect to changes that would be necessary to implement an electronic filing requirement. Moreover, all of the information that unions will need to update their internal recordkeeping and reporting requirements for the proposed Form LM-2 will be contained in the final rule that is published in the Federal Register.

Question. Unions have a legal obligation to represent their members in the workplace, and fulfilling these obligations costs money. As I understand your proposal, even local unions will have to spend thousands of dollars to comply with the new financial requirements.

What possible justification could you have to take money away from representing workers so that unions can comply with paperwork requirements imposed by the government?

Answer. The Labor-Management Reporting and Disclosure Act of 1959 which was passed by large majorities in both the Senate (a 95 to 2 vote) and House (a 352 to 52 vote) requires that labor unions file annual financial reports with the Secretary of Labor setting forth certain specified information in such detail as may be necessary to accurately disclose their financial condition and operations. The Congress considered disclosure of such information to be necessary to protect the rights and interests of union members and the public.

In satisfying this congressional mandate, the Department's proposed rule attempts to balance the rights of union members and others to disclosure of the financial information called for by the statute with the burden placed on unions to furnish that information.

The principal changes being proposed by the Department to improve transparency and disclosure affect only the largest unions (approximately one of every five unions). As also noted in the proposed rule, significant improvements in the software available to facilitate accounting make it possible to change the form LM-2 in ways that will provide additional useful information to union members and the public without unduly burdening unions. The Department is currently reviewing over 35,000 comments received on the proposed rule, many of which address the level of reporting and the associated burden.

CONCLUSION OF HEARING

Senator SPECTER. Thank you all very much for being here. That concludes our hearing.

[Whereupon, at 4:43 p.m., Thursday, July 31, the hearing was concluded, and the subcommittee was recessed, to reconvene subject to the call of the Chair.]

